# RURAL ELECTRIFICATION ADMINISTRATION BIDDING, PURCHASING, AND ELECTION PROCEDURES

## HEARING

BEFORE THE

## SUBCOMMITTEE ON AGRICULTURAL CREDIT AND RURAL ELECTRIFICATION

OF THE

## COMMITTEE ON AGRICULTURE, NUTRITION, AND FORESTRY UNITED STATES SENATE

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# CONTENTS


Page

Hawkins, Hon. Paula, a U.S. Senator from Florida, opening statement ..... 1

CHRONOLOGICAL LIST OF WITNESSES

Hunter, Hon. Harold V., Administrator, Rural Electrification Administration. 2
Doyle, Jack, director, Rural Land and Energy Project, Environmental Policy Institute ..... 8
Magee, Robert E., Deputy Inspector General for Investigation, Office of Inspector General, U.S. Department of Agriculture ..... 17
Birkle, Baltas E., Deputy Director, Community and Economic Development Division, U.S. General Accounting Office, accompanied by Richard E. Renzi and Ed Allen ..... 20
Mortenson, G. Russell, Hughes & Hill, Dallas, Tex., representing Riverside Industries, Tulsa, Okla ..... 24

APPENDIX

Hunter, Hon. Harold V., Administrator, Rural Electrification Administration, statement ..... 43
Doyle, Jack, director, Rural Land and Energy Project, Environmental Policy Institute, material submitted by ..... 47

# RURAL ELECTRIFICATION ADMINISTRATION BIDDING, PURCHASING, AND ELECTION PROCEDURES

TUESDAY, OCTOBER 20, 1981

U.S. SENATE,
SUBCOMMITTEE ON AGRICULTURAL CREDIT AND
RURAL ELECTRIFICATION OF THE
COMMITTEE ON AGRICULTURE, NUTRITION, AND FORESTRY,
*Washington, D.C.*

The subcommittee met, pursuant to notice, at 9:30 a.m., in room 322, Russell Senate Office Building, Hon. Paula Hawkins (chairman of the subcommittee) presiding.

Present: Senator Hawkins.

## STATEMENT OF HON. PAULA HAWKINS, A U.S. SENATOR FROM FLORIDA

Senator HAWKINS. The hearing will come to order. I am Paula Hawkins. I am chairman of the Senate Subcommittee on Agricultural Credit and Rural Electrification. Today we will hear testimony concerning bidding, contract procurement, and election procedures of electrical cooperatives that are financed by the Rural Electrification Administration.

In my home State of Florida, serious questions have been raised about the bidding, contracting, and election procedures used by the Seminole Electrical Cooperative. Seminole is a large, REA-financed generation and transmission cooperative serving west-central Florida. These reports disturbed me greatly and made me decide that it was time to review the current REA policies governing the agency's role as a regulator of these cooperative activities.

Apparently, REA has substantially reduced its oversight capability in the contract procurement area in the last 10 years. Admittedly, this trend at REA is consistent with President Reagan's deregulatory policies. And I, too, am a great supporter of deregulation where the result will be greater competition among the deregulated. But electrical cooperatives do not operate in a competitive business atmosphere.

We must remember that they enjoy a virtual monopoly within their respective service territories. My experience in electric utility regulation as the Public Service Commissioner of the State of Florida makes me want to see for myself whether or not this deregulatory trend at REA is justified.

We did not come here today to denigrate the past performance of the Rural Electrification Administration. In fact, since it became a full-fledged Federal lending agency in 1936, this agency has spear-

headed a successful effort to bring electric power to millions of people in rural America. Electrical cooperatives now provide electricity to 25 million people in 46 States. Their service territories cover more than 75 percent of the land base of the United States.

However, the staggering increases in electrical cooperative spending in recent years have caused the REA's annual outlays of Government-backed loans to increase dramatically. In 1936, the newborn agency had a total lending budget of only $40 million. In 1973, total REA programs equaled more than $650 million, and in 1980, the REA issued nearly $6.5 billion in insured and guaranteed loans.

These billions of dollars are used by the co-ops to purchase the materials, equipment, and power that they need. Considering the enormous amounts of money that are at stake in these cooperative ventures, it is evident that every U.S. taxpayer, as well as every co-op member, has a common interest in seeing to it that electrical cooperatives use good, sound business practices. I believe the REA policies in question here today may threaten that common interest.

We intend to start today a review process of these policies with this hearing to determine, for the good of the American people, and all rural co-op members, whether the current REA regulations are doing the job that they are supposed to do.

I would like to welcome as our first witness, Harold Hunter, the new Administrator of the Rural Electrification Administration. And I thank you for joining us today and for providing us with a very thorough document outlining REA policies pertinent to today's discussion.

Once you have presented your statement, Mr. Hunter, I would like to ask that you remain with us until the rest of the witnesses have testified so that we might have you answer some specific questions and to clarify statements that may be made by other witnesses regarding the REA policies that are stated here today. We look forward to your testimony.

## STATEMENT OF HON. HAROLD V. HUNTER, ADMINISTRATOR, RURAL ELECTRIFICATION ADMINISTRATION

Mr. HUNTER. Thank you, Senator Hawkins. We do appreciate the opportunity actually to sit with you and to study some of the needs that exist within REA.

First, if I might, I would like to ask if I could highlight these remarks rather than read them in total because it is provided here for the record.[1] I will follow the general text as I do so.

Senator HAWKINS. Sure.

Mr. HUNTER. The first part of our remarks do deal with the same things that you have testified on, and that is the magnitude of the electric program, which is substantial. In the fiscal year that we have just completed, we have approved loans of about $850 million under the insured loan program and almost $5 billion under the guaranteed loan program. These loans went to 354 distribution cooperatives and 25 generation and transmission cooperatives.

The insured loans, as you know, are basically at the 5 percent interest rate, with some of the loans at the mandated 2 percent interest rate. And these will come from the rural electric and the

[1] See p. 43 for the prepared statement of Mr. Hunter.

telephone revolving fund, while the guaranteed loan funds will basically come from the Federal Financing Bank under a standing agreement that REA has with that bank.

In the 46 years since the inception of the REA loan program, over $42 billion has been loaned or guaranteed. Of this total, only some $44,000 has been written off as a loss during those many years.

I would like to begin by discussing the area of the bidding and purchasing procedures which currently is a concern. Certainly the administration of a loan program of this size demands a certain degree of oversight and monitoring by REA. This is especially true in the area of how REA borrowers spend these loan and loan guarantee funds to build the distribution and generation system necessary to deliver electricity to the rural consumers of the Nation.

So the loan contracts entered into between the United States, or REA, and a given borrower have always provided REA the right to approve all contracts entered into by the borrower.

REA has set forth its policy regarding this relationship with its borrowers in REA Bulletin 2-1, which is a "Guiding Statement of REA Policy Concerning its Relationship With Borrowers." Let me read from the language of that bulletin:

> Policy: To achieve program objectives and to protect loan security, REA will, in its relationship with borrowers, base its activities on the following considerations: A. That each borrower is (1) an independent corporate body subject to all applicable laws and regulations; (2) responsible for the efficient and effective management of its own affairs, including proper and successful construction and operation of its system; and (3) expected to repay all indebtedness on or ahead of schedule according to the terms of its loan(s) and established policy.

There are six additional considerations within this bulletin, but they are not necessarily applicable and I don't think I will take time to get into those.

REA over the years has vigorously adhered to this stated policy through the development of a series of implementing bulletins. These have provided the REA with the proper controls and what we consider to be approving authority necessary to insure that the Government's interest is adequately protected, and that the benefits of the REA program are truly delivered to the eligible rural consumers.

One such bulletin deals with the area of purchasing of materials and utility plant construction. This is REA Bulletin 40-6, "Construction Methods and Purchase of Materials and Equipment." This outlines general requirements and procedures in connection with new construction and additions to plant.

The bidding and purchasing procedures detailed in our bulletins are based upon, we feel, sound, well-established business principles and have been well accepted throughout the utility industry. They have been in existence for many years, have withstood the test of time, and, in our judgment, result in the procurement of needed goods and services at the lowest possible cost. Additionally, they provide for widespread competition. REA borrowers are considered to be private entities and, as such, are not subject to the Federal procurement regulations.

If I could now, I will discuss briefly the major provisions of REA Bulletin 40-6.

The method of construction to be utilized in building transmission and distribution facilities—either force account, utilizing the borrower's own personnel, or employment of an outside contractor, although subject to administrative approval—is usually left up to the borrower to determine. I think you will find as I go through this testimony that we recognize a growing competence on the part of the borrowers and have left increasing responsibilities with them. When the employment of an outside contractor is deemed the best method to use in constructing the facilities, certain mandatory procedures then must be followed.

REA has developed a set of standard contract forms covering construction specification and so forth. The use of these standard forms for certain routine distribution construction practices, utilizing REA specification and material standards, does not require prior REA approval by the borrowers. However, other standard contract forms do require REA approval before they become effective for use. These generally deal with the more complicated phases of utility system construction, such as transmission and substation erection, whether performed by generation and transmission systems or by distribution systems.

With respect to generating plant construction, REA requires approval of approximately 12 major contracts associated with the construction of a major plant. These 12 major contracts, out of the approximately 100 contracts associated with the many construction phases of a major generating facility, represent approximately 75 percent of the entire construction cost of the generating plant.

With respect to the purchase of materials necessary for the operation of a generating plant, such as boiler fuel—oil, gas, coal, nuclear fuel, limestone, and so forth—and related transportation contracts, REA has, as previously stated, the right to approve any of these types of contracts. However, as the REA borrowers have matured and demonstrated their capability, REA has reduced its approval requirements and, with a few exceptions, returned this function to the individual borrowers. This is in keeping with the REA policy that I previously cited.

The REA borrowers generally discuss the contract terms and conditions with REA personnel prior to entering into any contract for the purchase and transportation of these commodities.

Approval would be required in those instances where an REA borrower is obtaining these commodities for the first time, or where the obtaining of these commodities is essential to the successful operation of a major generating plant financed through an REA loan guarantee. Of course, in those few instances where REA has provided loan guarantee funds for the development of coal mines, REA approval of coal supply agreements is required.

Bulletin 40–6 provides for the construction of facilities and the purchase of materials under different bidding procedures. These bidding procedures can be summarized under three headings, such as: (1) Formal competitive bidding; (2) informal competitive bidding; and (3) negotiated bidding.

Prior to utilizing any of these bidding procedures, it is the responsibility of the borrower and its consulting engineer to: First, determine what contractors or suppliers are qualified to perform or supply the services desired; second, to establish a bidder's list of a

sufficient number of qualified contractors or suppliers to insure a true competitive bid situation. REA recommends that a sufficient number of firms be invited to bid to insure that a minimum of at least three bids will be received.

It is also the borrower's responsibility, in concert with its consulting engineer, to:

> Assure that all bidders are treated fairly and that no bidder is placed in an advantageous or disadvantageous position with respect to the other bidders, and that the advantages of the competitive system of bidding are maintained for all * * *

Let me now discuss each of those various acceptable bidding procedures.

The one that is entitled formal competitive bidding requires that a sealed bid be submitted in response to the invitation to bid. The sealed bid is to be publicly opened and read at a specified time and place. Bids are examined upon opening to determine if they are responsive to the invitation and meet all of the major specified requirements of the contract, such as the terms and conditions, bid bonds, properly executed, no exceptions, and so forth. Nonresponsive bids are returned to the bidder without being read publicly. The contract is awarded to the lowest evaluated responsive bidder.

Informal competitive bidding. Under this procedure, sealed bids must be delivered by a prescribed time and place. The bids are opened in private. All bidders are aware that one round of negotiations is permitted to clarify proposals. Bidders are permitted to alter prices during this one round of negotiations. Pricing data of one bidder is not revealed to other bidders during these negotiations. Acceptable bids must be responsive to the bid documents and the contract is awarded to the lowest evaluated responsive bidder.

And the third form is negotiated bidding. Under this procedure, unlimited negotiations between the bidder and the REA borrower are permitted. Pricing data revealed by any bidder is not to be used to bargain with or be divulged to other bidders. The contract should be awarded on the basis of the lowest evaluated bid.

Negotiated contracting procedures are almost always required in obtaining acceptable commodities and transportation contracts.

The next paragraph that I will touch on I think covers very carefully a summation of what is happening in REA and I think addresses itself very well to the overall things that we are considering here today.

REA over the years has developed its bidding and contracting procedures to expressly accommodate the REA policy that I previously stated. These procedures allow the REA borrowers to act as independent consumer-owned local entities, while providing the U.S. Government sufficient control to properly oversee how the funds provided through the various REA lending programs are used. A measure of this balance between rigid REA controls and local independent stewardship is demonstrated by the contracts requiring REA approval in the construction of a major generating station.

As we all know, electrical generating stations being constructed today can run well over $1 billion. By reducing the number of contracts requiring approval from approximately 100 to just 12 major component contracts, representing 75 percent of the cost of

the plant, REA provides this balance between regulation and independence. REA is proud of the relationship and respect it has earned over the last 45 years in the utility industry, from not only other segments of the industry but from utility contractors and suppliers alike.

Now to touch on some of the relationships between REA and distribution cooperative boards of directors.

The legal basis for the cooperative's assistance is set forth in its articles of incorporation. Another important legal document is the bylaws that relate to the articles of incorporation. These documents set forth the rights of the members and the duties and responsibilities of its officers and board members.

REA has a set of model act bylaws. These bylaws are recommended for cooperatives' use, but are not required. However, all of the provisions of the model act bylaws may not be applicable to a specific system due to State statutes and other requirements. I think that we need to emphasize here that these cooperatives are organized under State law, and are subject to State law, and their organization has to be responsive to those laws which aren't necessarily the same, of course, in each State.

The board is the body responsible to the members for cooperative management. Except for the specific duties given to officers, each director shoulders an equal responsibility for the conduct of cooperative affairs.

REA conducts its relationships with the cooperative on the basis that it is an independent corporate body subject to all applicable laws and regulations. REA establishes terms and conditions in its loan security documents, and policies, and procedures to assure the proper implementation of REA objectives. We encourage the active participation of members in the affairs of their organization to assure maximum benefits to themselves and to the development of that community.

The cooperative's board is primarily responsible for policymaking, for planning, for exercising financial control, for reviewing the execution of policies and plans, and for charting the cooperative's course. Individual board members should inform themselves about the principles on which cooperatives are based, on why and how their own cooperative was organized and on other details that relate to their organization.

REA's activities are carried on in a manner to help develop the resources and ability of borrowers to meet their needs, handle their own affairs effectively, and to achieve as soon as possible the internal strength and soundness to assure their success as an independent enterprise. It is our intent that as borrowers develop this capability, direct REA assistance will diminish accordingly.

REA provides the borrowers with guidelines and recommendations for the nomination and election of a cooperative's board of directors. REA Bulletin 101–5, "Model Act Bylaws," recommends suggested procedures, including secret ballot elections and states as follows:

> The persons named as board members in the articles of incorporation shall compose the board until the first annual meeting or until their successors shall have been elected and shall have qualified. Members of the board shall be elected by secret ballot at each annual meeting of the members beginning with the year 19—

by and from the members to serve until the next annual meeting of the members or until their successors shall have been elected and qualified.

REA's Bulletin 101-4, "Annual Meeting Guide," includes further recommendations as to nomination and election procedures. Nominations may be made by committee or from the floor. At least two candidates should be nominated for each board position.

In addition to these recommendations, prior to district meetings or the meeting of the nominating committee, REA requires that cooperatives annually notify their members of the provisions of the bylaws pertaining to membership requirements, meetings, board representation, nomination, and procedures for election to the board.

REA is not a regulatory body, nor should it be. The question of how much and what type of regulation is needed or required properly belongs to and is the responsibility of the State. Before the bylaws, or any changes thereto, are adopted by the cooperative, the cooperative must insure that the bylaw provisions are consistent with any State statutes applicable to the cooperative as well as to the loan security documents of REA. In connection with each loan, the borrower's attorney certifies that examination has been made of "* * * all corporate proceedings of the borrower relating to the election of the directors and officers * * *," and that these actions were in accordance with the cooperative's bylaws.

REA also requires the cooperative to advise each member of bylaw changes and to notify each member that copies of the bylaws are available at the cooperative's office.

REA's policies provide oversight and monitoring, but officially recognize that its borrowers are independent and private organizations. Provided that a borrower's actions are consistent with its bylaws and legal requirements, REA would intervene in the cooperative's affairs and take appropriate action only if the Government's loan security were in danger or if REA objectives were not being carried out. While REA maintains continuing oversight and makes recommendations through bulletins and individual discussions, the ultimate decision as to bylaw provisions on nomination and elections rests with borrowers' member-owners.

I hope these opening remarks have established for the committee the framework and methods with which REA approaches its program responsibility. We are trying to establish a balance, and maintain a balance, between program objectives, the security of the Government loans and the self-independence of rural people to collectively provide rural America with the benefit of adequate and dependable electric power.

The REA contracting and bidding procedures and its relationships with cooperatives' board of directors have evolved over the years.

REA recognizes that its procedures need to be in a process of constant review in order to meet the requirements of a rapidly changing industry. Naturally, we would be willing, and happy, Senator Hawkins, to discuss and consider any recommendations which do come from the study of this committee. We recognize, as has been said, that we do live in a fast-moving, changing economy. The electric industry is under considerable change. These changes to a considerable degree make greater and different demands upon

the way that REA should represent the interest of the taxpayer, and also the borrower and the people who they borrow from.

Naturally, I will be available to consider any questions that may come up later. And I appreciate this opportunity to be heard by your committee.

Senator HAWKINS. Thank you so much, Mr. Hunter. If you would stand by, please for further discussion.

Our next witness will be Jack Doyle of Washington, D.C. Mr. Doyle is the director of the rural land and energy project at the Environmental Policy Institute. He has authored a book entitled "Lines Across the Land," an indepth study of the electrical cooperative system. Mr. Doyle will speak about the results of his research on co-op election procedures and the concepts of self-regulation. Electrical co-ops are said to be self-regulated through the participation by members and annual elections by the board of directors. This rationale is used to justify the decision by at least 21 States to not regulate electric co-ops in any manner.

Mr. Doyle, we look forward to your testimony here today.

## STATEMENT OF JACK DOYLE, DIRECTOR, RURAL LAND AND ENERGY PROJECT, ENVIRONMENTAL POLICY INSTITUTE

Mr. DOYLE. Madam Chairwoman, it is good to be here. I have a prepared statement that I would like to read. I will try to edit some of this.[1]

For the record, my name is Jack Doyle. I am director of the rural land and energy project of the Environmental Policy Institute, a Washington-based public interest research and educational organization focusing on energy and natural resource policy at the Federal level.

We are pleased to be here today, and hope that our testimony and supporting material will be helpful to the subcommittee in its inquiry of REA and co-op procedures.

We released our study 2 years ago, "Lines Across the Land," one of the largest and most costly studies ever undertaken by the Environmental Policy Institute. "Lines Across the Land" investigated the REA and co-op systems on a wide range of topics, including their history, their environmental record, their relationship with farm groups, their relationship with investor-owned utilities, their political power base, their changing structure, and their energy policies. More than half of the book is comprised of 14 case studies, some of which were written by co-op members.

We believe that "Lines Across the Land" has performed a public service for many rural people and cooperative members all across the country. We further believe that our study was a fair and accurate analysis of how REA and rural electric cooperatives operate throughout rural America and in Washington, D.C. We stand by its findings.

Contrary to some of the study's detractors—whose initial knee-jerk responses even before reading the study, charged that we were out to "get REA" or "ruin the REA system"—our intention, stated many times in public and in the press, was to move the REA system closer to its members, back to its original progressive tenets, and to suggest that energy conservation, solar, and other

[1] See p. 47 for additional material supplied by Mr. Doyle.

renewable energy options could provide the substance of reform and revival throughout the entire REA system. And it is from that premise, and with these intentions of reform and redirection, that we appear here today to offer our views.

Among some of the most disturbing findings in "Lines Across the Land" were those having to do with how rural cooperatives relate to their consumers. Rural electric cooperatives, unlike investor-owned utilities, are owned and operated by the consumers, who are often referred to as member-owners.

Co-ops are supposedly run on democratic principles of equal representation, open access to meetings and information, and the opportunity for any member to run for a board seat. Co-op members, in other words, are supposed to run and control their own cooperatives. Unfortunately, this is not what we found in "Lines Across the Land."

Although rural electric managers and directors, and even REA officials, have stated that co-op members can work within the co-op system to change policy and propose their own initiatives, we found evidence to indicate that such opportunity to effect policy change, or to challenge specific co-op decisions, was subtly qualified, restricted, or simply quashed by dictatorial local managers, co-op lawyers, and, in some cases, G. & T. officials.

Some of the findings in "Lines Across the Land" concerning member access to information, co-op elections, and redress and appeal procedures include the following:

In some States, the governing bylaws of co-ops are sometimes denied to co-op members, or are not routinely distributed to new co-op members unless requested in writing;

Some co-op bylaws vest local boards with the power to set rates, policy, and operation charges without membership notification or approval;

In some States, co-ops have not abided by the terms of their original State charters;

In Alabama, Minnesota, Illinois, Virginia, and other States, co-op members have been denied such information as mailing lists of co-op members—in this case, when someone wants to run for a board seat they need to be able to reach the membership. Other information often denied members include: Copies of agreements which form G. & T. systems to which co-op members belong, contracts and agreements pertaining to power projects from which members will receive power and upon which future rates will be based, minutes of general co-op and board meetings, and the right to inspect co-op books and records;

Some co-ops have refused to disclose fees paid to directors and to their own members;

At annual meetings in some co-ops, members have to be on a formal agenda in order to speak;

In Texas and Minnesota, local co-op members in some systems have been denied the opportunity to speak from the floor at annual meetings;

Again, in Texas and Virginia, proxy votes have been used to swing local co-op board elections to favored candidates;

In Minnesota, mail ballots have been used in the election of board members. Even though in this particular case in Minnesota,

the mail ballot was by law made illegal for use in elections, they continued to use the mail ballots;

In some co-ops, local board members have not resided in the co-op service area while serving on the board;

Petition, redress, and recall procedures in some co-ops are often subject to review and judgment by local co-op directors, even when such petitions or recall motions are directed at the board members themselves;

In Ohio and Alabama, member-initiated petition drives for redress or recall purposes have been stymied or disqualified on the basis of "improperly drawn petitions", "duplicate signatures", or on the grounds that individual petitioners "had not signed their membership cards". And in that case, the one case in Alabama there were as many as 1,500 signatures disqualified because members supposedly did not sign their membership cards;

In one local co-op board election in Illinois, an incumbent board of directors sent a letter to co-op members smearing a co-op member who was a candidate for a board seat. That story is documented in some detail in "Lines Across the Land".

Sadly, these practices have not abated since the publication of "Lines Across the Land" in the fall of 1979. In June 1980, for example, the Dunn County Electric Cooperative in Wisconsin witnessed a struggle over a challenge to a bylaw provision that was only adopted the previous year. That provision limited board seats to three successive 3-year terms, or 9 years for any board member. Board members favored amending that provision in order that they would all be grandfathered in, so that the three-term limitation would only begin ticking as of January 1, 1981. In other words, the board's position was that existing board members, regardless of how long they had been in office, should be given another 9 years.

Co-op reformers felt that the provision should stand as originally incorporated, meaning that anyone presently on the board who had served three successive terms or more would not be eligible to run again.

Shortly before the annual meeting, the manager of the co-op sent a letter to the membership explaining that the original limitation was backed by a small group of people who were trying to take over the co-op. After three separate counts of the vote at the annual meeting on this provision, it was determined that the supporters of the original limitation had narrowly won. The last count was supposedly the official, final vote.

However, a few days later, the manager called a special board meeting and called in three special ballot counters, whereupon, the board determined that the official vote had actually been in favor of the board-supported position.

Supporters of the original limitation are today—this very day—in court suing the co-op over the incident, noting that the board had conducted an illegal recount, had a vested interest in the outcome of the vote, and had violated co-op bylaws by not making proper notification of the meeting.

Incumbent local boards have become a problem for many co-op members all across the country, with some board members serving as many as 20- and 30-year terms. These board members often

comprise the nominating committees or appoint such committees, who then determine candidate slates for co-op elections.

It is not surprising, therefore, that incumbent boards are re-elected time and time again. This is why a limitation on term of service is such an important first step for co-op members trying to restore democratic control to their co-op.

On a similar measure to that tried in Wisconsin, also limiting the terms of board members to three successive 3-year terms, the Illini Electric Cooperative of Illinois faced a vote in February of this year. According to one co-op member who attended that meeting, there was a "concerted effort on the part of the board to get votes against this amendment."

This is not to say that there have not been any reforms. Some co-op reformers in Minnesota and Michigan have themselves been elected to local co-op board seats. In Minnesota, a "co-op bill of rights" was offered in the State legislature and is still pending this term. A similar measure is being proposed for Wisconsin and probably for some other States as well.

Co-ops in Minnesota now have the right to bring themselves under State regulation through votes of their local co-op membership, and a few have elected to do so this year. But such reforms tend to be the exception rather than the rule.

In many respects, the problems of member access to information and fair treatment in election, redress, and recall procedures, flow from the changing structure of the REA system nationwide. Since the late sixties, and even somewhat before then, political and financial power within the rural electric system has moved away from the 950 local co-ops and increasingly toward some 50 G. & T. co-ops. "G. & T.'s", as they are called, are generating and transmission co-ops, and each G. & T. has what we call a family of local co-ops, as many as 50 or 60 in some cases.

Electric service and supply decisions have become increasingly centralized and lodged at the G. & T. level. Consequently, co-op members at the local level are the last to know of G. & T. plans for future power supply, and it is these decisions that often have to be defended and protected by local boards, and such defense often manifests itself in various undemocratic ways.

Although G. & T.'s are fond of pointing to the "representative" composition of their boards, and the contention that "any decision made by the board of directors is subject to being overridden by the membership", very few, if any, major decisions, such as those to build a large powerplant or begin a joint venture with an investor-owner utility, are ever put to a full vote by the co-op membership within the G. & T. system. In fact, very few such decisions, involving millions of dollars, are seriously debated by local co-op memberships due to the strictures imposed upon member participation.

For example, in Kansas a few months ago, a local co-op member trying to discuss with his local board some questions about the merits of buying into the Wolf Creek nuclear power project was denied permission to attend the meeting, but was allowed to submit a list of written questions.

The rural electric establishment spends large sums of money "educating" its managers and boards of directors, gives generously to political candidates of both parties, and is not bashful about

selling its point of view to the general public in major newspapers and magazines outside of rural areas.

Although local members, too, are barraged by co-op literature, it is for the most part the co-op point of view, or, more precisely, management's point of view. Even on some "so-called" opinion pages in co-op publications, letters from co-op members have been turned away because they did not agree with the "party line".

In a nutshell, what we found in "Lines Across the Land" is that the co-op philosophy as applied to the rural electric system has been turned upside down: Instead of being a democratic, grassroots, "bottom-up" system where policy is derived from member-to-manager, rural electric co-operative policy making begins at the very apex of the system, at the G. & T. level, and is forced fed downward to manager, director, local board members, and, ultimately, consumers through a wide assortment of techniques.

We believe that the REA system could revitalize itself, diversify its energy base, and save ratepayers and the Federal Government millions of dollars by pursuing a crash program in energy conservation and renewable energy options. Unfortunately, local co-op boards and G. & T. systems have "powerplant blinders" on and will not consider the vast, diverse potential that energy conservation and renewable energy options present to their systems.

We also believe that such a concerted effort in new energy sources could spur reform movements among co-op members and within State legislatures.

Unfortunately, local co-op boards and G. & T.'s have become quite comfortable with the status quo, and many have lost their flare and enthusiasm for innovation and the consumer's best interest. Since the Arab oil embargo, rural electric cooperatives have failed miserably with REA's weak-wristed energy conservation and home weatherization programs.

Since the Arab oil embargo, REA loans and loan guarantees for electric distribution lines, high voltage transmission lines and powerplants have totaled more than $30 billion. However, REA loans for energy conservation and home weatherization during that same period have totaled no more than $4 million, or about 0.014 percent of total REA financing during that period. A pretty poor showing for 7 years and a system that services 8 million REA familes, or 25 million consumers.

Even assuming an energy conservation expenditure of $30 million by all REA co-ops, the "conservation share" then rises to a mere 0.1 percent of all REA financing since the Arab oil embargo. In any event, within the REA system, there is a very wide gap between "electric growth" expenditures and "energy conservation" expenditures, and this has resulted in very large demands on Federal borrowing.

In closing, we would respectfully suggest to this subcommittee that "Lines Across the Land," and all the various newspaper accounts, GAO reports, and books on co-op powerlines, and so forth, may have only touched the tip of the iceberg. There are, no doubt, thousands of rural electric co-op people in rural America who have stories to tell about how their own local co-op could be doing a better job. We would encourage this subcommittee to go to the people; and go out into the country to solicit that opinion.

While REA and some local cooperatives have moved forward in good faith to try to improve the co-ops' energy conservation record, REA energy conservation programs have generally failed for three reasons: (1) They are not mandatory, (2) they are not tied to clear energy conservation goals, and (3) they are aimed at the wrong level—some 950 local co-ops rather than the 50 to 60 "G. & T. co-ops."

An energy conservation amendment aimed at G. & T. co-ops, with clearly stipulated energy conservation goals, and required as a condition of continued access to the Federal Financing Bank for loan guarantees, would have the effect of coordinating local co-op conservation programs throughout the Nation, while reducing the amount of off budget financing needed for new REA powerplants. In May 1980 testimony before the Senate Subcommittee on Agricultural Credit and Rual Electrification, former REA Administrator Robert Feragen presented a table which showed that the difference in financing requirements for a 1-percent rate and a 9-percent-growth rate in the REA system during the 1980–89 period would be $76.2 billion (in constant dollars). Using Feragen's table, and assuming an installed capacity cost of $1,200 per kW, the difference between a 3-percent and a 6-percent rate is roughly 16,000 MW, or about $25 billion in financing costs for the 1980–89 period. Such differences—made possible through an energy conservation requirement aimed at the G. & T.'s—could result in significant savings in Federal credit outlays.

Such a requirement would help coordinate local co-op energy conservation programs within G. & T. systems, would promote jobs in home weatherization and other energy conservation businesses throughout rural America, and would help reduce the amount of off budget Federal borrowing needed by REA to finance new powerplant construction. A 1 percent annual reduction in electric demand by G. & T. systems would save millions of credit dollars in Federal borrowing, "freeing up" such Federal borrowing for housing, agriculture, and small businesses.

There are problems of rate regulation, joint venture arrangements, and the lack of effort on energy conservation and renewable energy alternatives that all need to be explored in some detail.

We would also encourage this subcommittee to explore the relationship between local co-ops and the G. & T. systems, and how local co-op boards and co-op members really feel about the arrangements they have with G. & T. systems, how they feel about joint ventures with investor-owned utilities and how they feel about REA.

We thank the subcommittee for the opportunity to appear here today to express our views.

Senator HAWKINS. Thank you, Mr. Doyle. Your background is most impressive, and we really appreciate your appearing here on a short notice. And we will take note of going into the areas where the REA's are located.

Yesterday, I listened with great interest, to an advertisement in Washington, D.C. for REA, rural electric cooperatives. Has it been your experience that similar commercials are commonplace? Have you found as much advertising in rural areas as there is in Washington, D.C.

Mr. DOYLE. Yes, we have discovered advertisements throughout the country on a range of issues. The National Rural Electric Cooperative Association (NRECA), which is a trade organization representing rural electrics in Washington, usually sponsors ads in the Washington Post, the New York Times, Atlantic Monthly, and the New Republic. I have seen their ads in the Smithsonian magazine. There are a number of publications where NRECA has run quarter-page advertisements. For example, I have one here. This was in the Washington Post, Thursday, June 23: "If it ain't broke, don't fix it." And it goes into an explanation of how the REA system has worked over the years; why they may be facing some challenge now in Congress. But that is just one example. There are lots of others.

And there is certainly nothing wrong with presenting one's point of view. But, again, here with advertising, as with the policies derived within the REA system, within the co-op system, within the G. & T.'s, and so forth, the local members comprise the bulk of the system and NRECA ads do not necessarily represent the view of all the members in the system. And even though the trade association here in town says it speaks for the members, we have a stack of correspondence from members all over the country as a result of our publication arguing to the contrary on that point; that they need another voice. The point of view of the member who is trying to democratically participate in his co-op is not represented.

So we are thankful that this subcommittee has taken the initiative to invite a differing point of view to the table here.

Senator HAWKINS. It has been my observation that most ads that I read like that in the Washington newspapers are directed toward the elected officials in this area, and Congress in particular.

Are there other instances that you are aware of where they advertised locally the wonderful things about rural electric cooperatives, say, in a Washington newspaper that may not be a benefit to an REA customer in a rural area? And are there many REA customers in the Washington reading area?

Mr. DOYLE. Well, I think that the trade association will admit to you flat out that they are not really aimed at reaching rural electric consumers with these kinds of ads. Their national advertising program is called "Tell the Nation the Truth," for which they solicit money from local co-ops to pay for the advertising campaign. They will tell you that their campaign is directed at the policymaker and at the urban audience to win support for their program, which, politically, is a very savvy thing to do. I mean, they are a very savvy political organization.

But, again, whether the view that is expressed by NRECA represents the view of the majority of co-op ratepayers is open to question.

Senator HAWKINS. There are some States where the public service commission disallows advertising unless they can prove it is for the benefit of the ratepayer, whether it is conservation or education or some similar purpose. In those instances, if there is no regulation by the public service commission, again, it would be local option as to what way they want to spend their money.

Mr. DOYLE. We did not look into that issue of regulation, advertising regulation within States, but that is an interesting area.

One area that has bothered us with regard to advertising, and there were several instances here, and I can recall one case in Minnesota where there was a very controversial high voltage powerline running across the State of Minnesota from a mine mouth powerplant in North Dakota, a direct current powerline, which crossed a good number of agricultural areas and farmsteads. And there was some question about high voltage leakage and the effect of living near this powerline, which were raised, and about site selection, and ultimately about need for the facility and the additional power in the first place.

Some of the co-op members throughout the corridor where the powerline was sited, were raising questions about alternative energy, and were trying to work those points of view into their co-op. But back to the advertising question. The two G. & T.'s that were involved in this project—United Power Cooperative Association, and Cooperative Power Association, I believe—ran advertisements in some of the State newspapers suggesting that the need for the powerline was derived from agricultural energy requirements, that the farmsteads in that corridor actually needed the energy, when, in fact, the power was being brought from a North Dakota coal mine to serve some of the suburban regions in the Minneapolis-St. Paul area, and also to flow into a regional power pool with investor-owned utilities. So we felt that that kind of advertisement was somewhat misleading in terms of justifying that project on the basis of farmers' energy need.

Senator HAWKINS. As a public service commissioner regulating investor-owned utilities, I never had an objection as to how much advertising management wanted to purchase, or how much money they spent on advertising their product, because that is a managerial decision. I thought, well, management can pay for it. However, because of the high cost of electricity I felt the ratepayer should not have to bear the cost of advertising unless he had some say as to what the copy said, which can differentiate when it is an I O U between stockholders and ratepayers. How is this done in a co-op?

Mr. DOYLE. Well, again, we did not investigate the details of regulating advertising in the co-op system. But I think in some co-ops that we came across in our investigation that if you were a member and you went to your board and you asked to see advertising copy that the G. & T. system was about to display in a major newspaper, I think you would have, first of all, difficulty getting hold of the copy, and, second, making any, even suggesting changes, because, first of all, you probably, in some systems, would not have access to that decisionmaking process for advertising to begin with.

So this is really the crucial part of the whole co-op philosophy: That the members should have the say in policy, whether it is advertising, or whether it is a decision to build a large coal plant versus applying a solar application. So it really comes down to how members participate, what kind of access they have to their local boards, and so forth. It is the very nub of the problem.

Senator HAWKINS. You heard Mr. Hunter say that the election of the board members is controlled by State statutes. Is that correct?

Mr. HUNTER. Yes.

Senator HAWKINS. By State statutes. In doing the research and compiling the case studies that you did for the book, "Lines Across the Land," did you find any conflict in what actually happens in the election of board members and what the State statute requires? Or is this a gray area?

Mr. DOYLE. We did not make a detailed study of State charters for co-ops, and how the provisions for the election process for individual co-ops is consistent or not consistent with those State provisions.

I would assume that even local co-ops could vary their procedures, even within States, if they so chose. So there is a lot of variation. But I think that the telling part is within a local co-op or within a G. & T. system: Are they abiding by their own internal bylaws? That is what we questioned. We just looked at the basic bylaws in the local co-op and found that they were sometimes in conflict with their own bylaws, or they were subtly changing the rules of the game, or through appointing nominating committees. Incumbent boards would often appoint the nominating committees for the board seats. And, as I mentioned in my statement, that prolongs incumbency and makes it very difficult for "outsiders," even though they are co-op members, to make a run for a board seat.

Senator HAWKINS. This is a factfinding hearing, as you know, and the Administrator has expressed such willingness to look at and review many of the items that are going to be discussed here today. Do you have any information where the amount of money spent to affect the election of directors is limited, as, that is, contribution to the U.S. Senate campaign versus contributions to a candidate?

Mr. DOYLE. We have done some analyses of rural electric political action committees—and there are rural electric political action committees at the national level and each State, in some cases, has its own political action committee—and they contribute money to both parties and to candidates in both parties. And in answer to your question, I don't know, outside of the Federal statutes, where and how limitations apply to PAC's from State to State.

Senator HAWKINS. My question is really directed to the election of directors for the co-op.

Mr. DOYLE. I am sorry, I misunderstood. You are talking about within the co-op system?

Senator HAWKINS. Within the co-op. If someone wanted to run for election as a board member of the co-op, did you find any financial limits, by statute, that can be spent on the election for each of those seats?

Mr. DOYLE. No. Actually, this, as we understand, this issue has come up in your State. However, when we embarked on "Lines Across the Land", we didn't even think that a local co-op person would spend money to be elected to a co-op seat because this is a voluntary system, and there is compensation. But in some cases where you can find out what the compensation is, it doesn't appear to be that outrageous, but I am surprised to learn that there has been big spending in terms of a political campaign for some of these board seats. But I could see how that kind of competition and spending may take place at the G. & T. level because these G. &

T.'s are becoming, in many cases, very large and powerful systems in their own right.

Senator HAWKINS. But the compensation, in return for winning that election, seems to me to, as in the instance of Seminole, to be extremely low in proportion to what was spent on the election.

Mr. DOYLE. To what was spent?

Senator HAWKINS. Yes.

Mr. DOYLE. I really don't know.

Senator HAWKINS. It is a very low salary.

Mr. DOYLE. I really don't know the Seminole situation, but if we had known of that kind of thing before I think we would have taken a hard look at it.

Senator HAWKINS. Then you would not be surprised if we were to find this happening in other co-ops?

Mr. DOYLE. Well, I would say if it happened in one, it has probably happened in others. And whether there are allowances for this and whether it is applicable within the co-op's own bylaws for election procedures, that is another question. But it is a surprise to me because we never even thought of looking at that kind of thing, because we were looking at the volunteer-type system.

Senator HAWKINS. That is what most people think it is, a service that is rendered in order to bring life support service to the rural area. Obviously, now that rural elective co-ops not only distribute, but generate electricity, the sums are larger and, with many other things, reform probably is long overdue because of the lack of interest or knowledge in this area.

Mr. DOYLE. Some of the G. & T. systems are very large, and comprise as many as 100 local co-ops and cover or serve portions of eight States in the West. For example, one G. & T. system in Georgia covers virtually the whole State in its service area. So they are substantial in size and, I would say, political influence in those States as well.

Senator HAWKINS. This is an area which we will examine in the future.

Mr. DOYLE. All right.

Senator HAWKINS. Thank you, Mr. Doyle.

My next witness is Robert Magee. Mr. Magee is the Deputy Inspector General for Investigations at the Office of Inspector General of the U.S. Department of Agriculture. Mr. Magee, do you have a statement?

**STATEMENT OF ROBERT E. MAGEE, DEPUTY INSPECTOR GENERAL FOR INVESTIGATIONS, OFFICE OF INSPECTOR GENERAL, U.S. DEPARTMENT OF AGRICULTURE**

Mr. MAGEE. Madam Chairman, for the record, I am Robert E. Magee, the Assistant Inspector General for Investigations at the Department of Agriculture. I do not have a prepared statement because of the particular role of our organization, but I do hope to be able to answer any questions that may be of use to you and the subcommittee, subject to the customary constraints on the investigative process.

Senator HAWKINS. What sort of fact situation must you have before you start an investigation of an REA-financed co-op?

Mr. MAGEE. Well, Senator, essentially the same kind of facts that we require in instituting any investigation. We react in terms of receipt of complaints, a request for investigation, either from the program officials or advice that there may be some possible violation of the Federal criminal statutes, which we may receive from members of the public, a Member of Congress, from some other Federal investigative agency who receives information, and, for that matter, perhaps even a call to our "hotline." In the case of REA, the bulk of our investigative services in the past as concerns REA have had to do with allegations of either misuse or diversion of loan funds, or the potential or possible violation of the Federal criminal statutes by either an employee of the REA or someone in a co-op. But, generally speaking, we get our requests or initiation of investigations under all these circumstances. But I must say that having said that, then the question of resources and priorities always come into play. And it follows that not every matter offered for a potential investigation is necessarily pursued or at least not pursued in any particular priority area.

Senator HAWKINS. How do you decide whether or not to begin an investigation?

Mr. MAGEE. Well, essentially, it has to do, first, with whether there is any potential violation of the Federal criminal statutes. In such cases, there is always an instant initiation of investigation. Even absent those circumstances, if there is a possibility or if there are indications of a substantial loss to the Government, either actual or potential, or the possibility of serious misconduct or, for that matter, nonfeasance on the part of any departmental employee, we would nonetheless proceed without the criminal aspect if it was within the interest of the Department. And, finally, questions having to do with the integrity of the operation of USDA programs is another area where we generally address our priorities.

Senator HAWKINS. Could you say approximately how many REA-associated or -related investigations you initiate each year or in the last 3-years?

Mr. MAGEE. I can provide that for the record.

[The following information was subsequently received by the committee:]

Investigations initiated over the past 3 years: 1979, 10; 1980, 6; and 1981, 10.

Mr. MAGEE. Generally speaking, the investigative activity in the USDA, as concerns REA, is relatively low level compared to the widespread investigative activity that attends programs like the food stamp program, the Department's home loan programs, and programs where there are Federal employees involved in many stages of the administration of a program, or the inspection requirements and things of that nature.

Senator HAWKINS. Has it accelerated at all since 1973?

Mr. MAGEE. I would have to say no, but I could provide you information for the record on that.

[The following information was subsequently received by the committee:]

The level of OIG investigations related to REA operations has remained generally constant over this period. Our computer data on investigative activities, available from 1975 on, reflects these numbers:

| Fiscal year: | *Number of investigations* |
|---|---|
| 1975 | 5 |
| 1976 | 2 |
| 1977 | 7 |
| 1978 | 2 |
| 1979 | 10 |
| 1980 | 6 |
| 1981 | 10 |

Senator HAWKINS. As was mentioned earlier, there have been serious allegations made regarding bidding, purchasing, and election procedures followed by the Seminole Electric in my home State of Florida, and I wonder if you would be able to tell us exactly what you have discovered so far in that investigation.

Mr. MAGEE. Well, I am afraid that I am unable to address the specific developments or, for that matter, the particular issues that we are proceeding on.

I can confirm that, in July, we initiated an investigation upon receipt of information from the REA, that it was established as a high priority investigation, that it is active now, and that it embraces both the areas of bidding and contracts with respect to the co-op in Florida you refer to.

Senator HAWKINS. Are there any other Federal law enforcement agencies involved that you know of?

Mr. MAGEE. The team of special agents who have been assigned to this investigation have been in consultation with representatives of another Federal investigative body, the FBI. But I would not want to speak for the FBI in terms of their having entered or assumed a role in the investigation.

Senator HAWKINS. When do you expect your investigation to be completed?

Mr. MAGEE. I can't be precise, but it follows that given the work load in the Department and our interest in proceeding expeditiously we are prepared to put whatever resources we have to on this particular matter. And I would expect that within a period of, hopefully, 60 or 90 days—and I might have to back away from that—that we would at least be at the point where it would be clear to us that violations of concern to the U.S. attorney had been established or had not been established, as the case might be. And that usually is the turning point of our investigations because if there is to be no criminal justice process, then we have to consult with the agency to determine what they need in order to effect program corrections, and whether those needs can be best served by investigative personnel or other personnel of the Inspector General's Office.

Senator HAWKINS. After you have done an investigation of this kind, do you make recommendations then to the agency—the many different agencies, as you said, the food stamps, Farmers Home, et cetera—do you then make recommendations to the agency as to corrective measures so it may not happen again?

Mr. MAGEE. Yes, Senator, that is a common byproduct of the investigative process, and, of course, a constant product of the audit operation. We report in different fashions, however.

The investigative process, which, as I said, is almost entirely limited to a criminal investigative process, results in a report that is used almost exclusively for legal purposes, either by the U.S. attorneys or the attorneys within the Department of Agriculture,

and perhaps for adverse personnel actions. But, if in the course of these investigations, we discover weaknesses or inadequate controls over certain processes, we will then make that information available to the agency, either in direct consultation or by issuing memorandums to them. And if it is a particularly serious situation, we will frequently address the problem in our semiannual reports to the Congress.

Senator HAWKINS. Thank you, Mr. Magee. We will look forward to your 60 to 90 days report.

Mr. MAGEE. I will look forward to it, too, Madam Chairman. I hope I don't have to retreat from that.

Senator HAWKINS. Thank you for coming to help us here this morning.

We will now go back to hearing Mr. Birkle, who is the Deputy Director, Community and Economic Development Division of the U.S. General Accounting Office [the GAO]. And Mr. Renzi, senior evaluator, with the GAO office. Mr. Birkle and Mr. Renzi will discuss with us the significance of REA's role in urging co-ops to make increased member participation a priority concern. Do you have a statement or would you prefer to answer questions?

**STATEMENT OF BALTAS E. BIRKLE, DEPUTY DIRECTOR, COMMUNITY AND ECONOMIC DEVELOPMENT DIVISION, U.S. GENERAL ACCOUNTING OFFICE, ACCOMPANIED BY RICHARD E. RENZI, AND ED ALLEN**

Mr. BIRKLE. Yes, Madam Chairman, I have a statement, a short statement.

We are here today to discuss member participation in the activities of rural electric cooperatives funded and supported by the Department of Agriculture's Rural Electrification Administration. This is one of the aspects discussed in our November 1980 report entitled "Financing Rural Electric Generating Facilities: A Large and Growing Activity."

Here with me, as you have mentioned, is Mr. Renzi, who is a senior evaluator and was team leader on the job that produced this report. And also with us is Ed Allen, who is the senior group director in GAO in charge of work at REA and other agencies related to business and area development programs.

REA was established in 1935 as part of an unemployment relief program. With REA assistance, rural electric cooperatives were formed to build and maintain electric distribution systems to serve their rural members. For the most part, the cooperatives purchased electric power from Federal power projects or electric companies and distributed it to consumers.

As the distribution network expanded nationwide, the distribution cooperatives began to form member-owned generation and transmission or power supply cooperatives. Initially, these power supply cooperatives served largely as service organizations for the members, arranging and contracting for the purchase of bulk power which, in turn, was sold to distribution members. Subsequently, some of these power supply cooperatives began to build their own generating capability to reduce their dependence on outside sources of electric power.

Distribution cooperatives have boards of directors that establish policy for the system. The directors are elected by individual consumer/members, who have one vote each, at the cooperatives' annual meetings. Individual consumer/members are free to make their opinions and concerns known to the board of directors at any time and, of course, the directors can be replaced, or voted out, at the annual meetings if sufficient numbers of consumer/members are dissatisfied with the board's actions or policies.

Power cooperatives also have boards of directors that establish policy for the power system. The board of directors of the power supply cooperative are typically selected directly by the directors of the member distribution system, most of which are also cooperatives.

A fairly typical example of the organization of a power supply cooperative is found in the United Power Association in Minnesota. The 21 members of the board of directors of this power cooperative are selected by the boards of the 15-member distribution cooperatives from among their own individual directors. Five distribution cooperatives choose two directors each, and the other 10 cooperatives select one member each plus one at large member.

This power system's 21 board members attend monthly and annual meetings to set policy and agree on major decisions. The annual meeting is also attended by all the board members and managers of the 15 distribution cooperatives who attend as observers.

Indirectly, the power supply cooperatives are owned by the individual consumer/members that make up the distribution cooperatives. But normally, the consumer/members are not asked to participate in the power supply cooperative's annual meetings. Of course, individual consumer/members can indirectly affect the policies and activities of the power cooperatives through the election of directors of the distribution cooperatives.

Because of concerns over energy costs, the environment, and conservation, and because of the impact large generation and transmission facilities can have on people's lives, we pointed out in our November 1980 report that there apparently was a need to gain increased participation of individual members, private citizens and others in the planning and decisionmaking processes of cooperatives. Unfortunately, our review showed that consumer/member participation has been limited.

Specifically, we reviewed the average attendance of members at the annual meetings of 70 randomly selected distribution cooperatives for the period 1974 through 1978. The attendance at the annual meetings of only 23 of the 70 cooperatives, or about one-third, averaged more than 10 percent of their members. Even with vote proxies added to the attendance figures, only 26, or about 37 percent, of the cooperatives averaged more than 10 percent participation by their members.

According to a former REA Administrator, member participation was not always a problem. When the REA program first began and cooperatives were being formed, the members were actively involved. Once members became sold on the concept and familiar with the benefits, they were eager to take part in a cooperative

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venture with their neighbors. Most cooperatives were small and relied heavily on the direct assistance of members.

As rural electrification became established and the cooperatives grew larger, there was a gradual lessening of direct member participation. There were relatively few new issues in which member participation was necessary. Rates, a primary member concern, were in a steady period of decline up through the 1960's. Virtually every area of the country was reached with service and this service was increasingly more reliable. The operations of the cooperatives were, for the most part, left to the staff and the boards of directors.

The results of a survey conducted in early 1979 by one distribution cooperative gives further insight into the problem. While these results may not necessarily be typical, in responding to a question on how many of the regular meetings the members had attended, 73 percent said none, and, more importantly, 61 percent said they did not want to attend any meetings.

In our November 1980 report, we recommended that REA require borrowers to take aggressive action to solicit the views and opinions of individual consumer/members in power supply planning and in other major decisions. The report suggested two ways this could be accomplished. First, power cooperative representatives could attend annual meetings of the distribution cooperatives and/or hold special meetings in the areas served by distribution cooperatives to discuss major issues and the power cooperatives plans. In addition, we suggested that questionnaires or polls be used to obtain consumer/member opinions.

REA recognizes that a need exists to get more consumer/member involvement in cooperatives and is working toward this end. In 1979, it placed its Office of Information and Public Affairs in the Office of the Administrator to give higher priority to member involvement and effective communication. Also, in commenting on our issued report, the Department of Agriculture stated that our suggestions were presently employed by REA borrowers. Further, it stated that our recommendation could be accomplished through a continued oversight role with individual borrowers.

Madam Chairman, this concludes my prepared statement. We would be pleased to respond to your questions.

Senator HAWKINS. Did the GAO study that you referred to indicate why member attendance has been so low at co-op meetings, other than apathy?

Mr. BIRKLE. Well, basically, that seemed to be the main reason. Most of the members apparently felt that things were going well, and that they didn't really need to attend the meetings. I assume if they became aware of a problem or a concern, such as the Coal Creek project which was mentioned earlier in the hearing, then a lot of the members would get concerned and started turning out at the meetings. But as long as there is no problem, at least in their mind, they don't see any need to go to the meetings.

Senator HAWKINS. Why does the GAO believe that greater member participation is necessary in the decisionmaking process of an electrical co-op?

Mr. BIRKLE. Well, we think that in the basic structure of a co-op it is inherent to have member cooperation and participation, and that if you don't, what will result, ultimately, is that the control

and the operation of the co-op will fall into the hands of a few people rather than a majority, and you could wind up having actions and decisions being made that are based on the desires and the will of a few rather than the majority.

As we point out in the report and in this testimony, with the great expansion that has occurred in the power generation and co-op activities, it becomes more and more important for membership to be involved and be concerned. Because of these many different considerations—environment, energy costs, and conservation all these things should be of direct concern to the members.

Senator HAWKINS. Could the sheer complexity of generating and distributing electricity and the billions of dollars involved effectively reduce attendance due to the complexity of the subject matter. Doesn't today's situation differ fom the 1930's when meetings were social gathering where members could discuss the benefits brought to everybody by setting up poles, and stringing lines, and just wheeling electricity in, rather than as it is today, a complex billion dollar business?

Mr. BIRKLE. That may be part of the reason. Also, people may feel today that a few people are in control, and they don't really have much opportunity to voice their opinion and have much say. So why bother coming out. Why bother to turn out for the meeting.

Senator HAWKINS. Have you followed up on your recommendation for REA to push for greater participation?

Mr. BIRKLE. No, we have not really followed up on that since issuing the report. So we really can't say whether it is working or not.

Senator HAWKINS. I am sure you are aware of my request that a GAO investigation be undertaken on current bidding and contracting procedures that are required by the REA of the co-ops.

Mr. BIRKLE. We will be meeting with your staff this week to talk more about the scope of that request and what we will be able to do for you within the timeframe that you have set.

Senator HAWKINS. Thank you so much. We feel that such an investigation is in the public's interest as the price of electricity increases and as the source of fuel becomes of more and more concern.

We should be concerned with ensuring the very best bidding contract and procedures available because of the public interest.

Mr. BIRKLE. Well, we certainly will try to help you all we can with the request that you sent to us.

Senator HAWKINS. Thank you for coming to us today and giving your time to provide us with a record on which to base our further inquiry.

Our next speaker is Russell Mortenson. He is a Dallas attorney. He represents a steel tower manufacturer from Tulsa, Okla., and has done business in the past with electrical cooperatives. He has presented his statement and sworn testimony highlighting his arguments which challenge the REA's decision to allow co-ops to opt for an informal bidding procedure where bidding is required.

Mr. Mortenson is going to present two cases that he is involved in that demonstrate the kind of abuse that can result when the informal bid procedure is used by co-ops' management. And I want to enter into the record my request that GAO and the Office of the

Inspector General cooperate with Mr. Mortenson in review of these two cases.

Mr. Mortenson, we welcome you today.

**STATEMENT OF G. RUSSELL MORTENSON, HUGHES & HILL, DALLAS, TEX., REPRESENTING RIVERSIDE INDUSTRIES, TULSA, OKLA.**

Mr. MORTENSON. Thank you very much, Senator Hawkins. My name, as Senator Hawkins indicated, is Russell Mortenson of the law firm of Hughes & Hill in Dallas, Tex. I appear before the subcommittee today representing Riverside Industries of Tulsa, Okla.

Riverside has over three decades of experience in and service to the power transmission industry as a designer and fabricator of steel lattice tower structures for transmission lines. It has been a staple supplier of steel structures to both investor-owned publicly financed, as well as REA-financed, cooperative utilities.

In a shrinking domestic industry which has witnessed at least five plant closures in the last several years in the face of foreign-government-subsidized competition from countries such as Italy, Korea, and Japan, Riverside is the only domestic lattice tower manufacturer which has committed major resources to modernize its plant equipment and to expand and upgrade its production capabilities.

The prime example of this is Riverside's construction, beginning in March 1980, of a new 200,000-square-foot plant to be located in Ogden, Utah. This new facility, with an approximate capacity of 3,000 tons per month, will more than double Riverside's total fabricating capacity and should make Riverside the largest single domestic lattice steel transmission tower fabricator.

Even so, Riverside is a relatively small business, with fiscal year 1981 sales of about $16.2 million and about 250 employees. Riverside, by no means, dominates the domestic market, but there are only about five producers with the capacity to bid projects on a nationwide basis.

Of course, REA-financed utilities are today a growing and a very important part of Riverside's market, especially in the growing Intermountain West and the Southwest.

Like any other small business, Riverside has a keen interest in being allowed to openly and freely compete in its markets which, of course, brings us to the point of these hearings and my testimony: Current REA procurement procedures for materials and construction create, and even sustain, arbitrary, capricious, and prejudicial treatment of suppliers such as Riverside and, because of the veil of secrecy drawn around bid openings and evaluations, create an atmosphere favorable to kickbacks, bribes, and award of contracts to other than the low, responsive, responsible bidder. Obviously, this means wasting money.

REA Bulletin 40-6 is the REA's primary policy statement regarding procurement of construction services and materials and equipment. Bulletin 40-6, as originally issued by the REA in 1970, stated in pertinent part:

> Experience has demonstrated the desirability of formal competitive bidding in the construction of facilities and in the purchase of materials and equipment. In some instances * * * REA requires that formal competitive bids be taken on construction

to be performed under a construction contract and on generation materials and equipment to be purchased under a materials or equipment contract.

When competitive bidding is not required, REA still recommends that, in general, borrowers use the competitive bidding method for construction of their facilities and for procurement of materials and equipment.

Where competitive bidding is required, deviations from the requirement will be made by REA only in individual instances, upon showing by a borrower that some other procedure would better serve its interest.

Where competitive bids are taken, the contract must be awarded to the lowest responsible bidder on the basis of the lowest bid, unless all bids are rejected or unless the borrower can show that the award of the contract on the basis of other than the low bid is in its best interest.

This basic precept—echoed here by the REA—that open, public competitive bidding is the best, fairest means to insure procurement of materials and construction services at the lowest cost, is one that has been at the very foundation of Government-sponsored procurement for many years. It is, for example, a basic component of both the armed services procurement regulation and the Federal procurement regulation and is a procurement technique consistent with the openness and fairness that we all expect and rightfully demand from Government-sponsored or -supported activity.

In fact, however, REA's commitment to fair and open competition is, at best, illusory.

In May 1973, REA issued its supplement to Bulletin 40–6 and, with the stroke of a pen, created a prostituted procurement technique euphemistically called informal competitive bidding, which, in a nutshell, allows REA-funded and guaranteed construction projects and material procurements to be conducted in secrecy, opening the door for the abuse of the competitive process we now see.

Incidentally, Senator Hawkins, this now seems to be a more prevalent procurement technique, and in Riverside's case, seems to be the dominant technique used by REA-funded utilities to procure steel towers today.

This informal competitive bidding technique: (1) Allows arbitrary exclusion of qualified potential bidders from even receiving bid packages; (2) allows favoritism in the selection of those allowed to bid; (3) allows for submission of bids by the select few who are allowed to bid in complete and total secrecy; and (4) allows for subsequent, closed-door negotiations with any bidder which can lead to the possibility of graft, comparison of noncomparable bids, and award of a contract to other than the lowest, responsive, responsible bidder.

As a specific example, I offer to the subcommittee the case of Sunflower Electric Cooperative, Hays, Kans.

On August 27, 1980, the Secretary of Agriculture announced the grant of direct loans and loan guarantee commitments totaling over $540 million to Sunflower, a small Kansas utility which had never constructed a steel lattice tower transmission line before.

In September 1980, Riverside expressed its interest to Sunflower to be allowed to bid for the steel towers needed for Sunflower's Mingo to Setab transmission line funded by the REA.

On October 24, 1980, Sunflower issued the bid packages, using the informal competitive bidding technique sanctioned by the REA in Bulletin 40–6, to every domestic tower manufacturer capable of producing the required quantity of steel, except Riverside. The

REA knew of, and apparently at least tacitly sanctioned, Riverside's exclusion from the field of bidders.

Riverside learned that the procurement was on the street only accidently, after another company inquired whether Riverside would be interested in a joint effort to produce part of the steel required for the project.

Riverside immediately protested its exclusion to both Sunflower and the REA, offering to present their qualifications to perform and offering to provide references. Riverside also offered to do whatever was necessary to submit a bid without delaying the bid receipt date.

Sunflower flatly and sternly rebuffed Riverside, and Riverside was even refused any explanation by Sunflower for its arbitrary actions, saying there was no REA requirement for them to explain their actions.

Why was Riverside excluded and why did Sunflower elect to use informal competitive bidding?

In connection with pending litigation between Riverside and another utility involving allegations of commercial defamation of Riverside, I took the deposition of Sunflower, through Kenneth Lennox, Sunflower's chief engineer and operating manager. With the permission of the Chair, I would like to read for the committee excerpts of Mr. Lennox's sworn testimony. Copies have been provided to the committee and the staff has access to the entire transcript.

The sworn testimony unequivocally shows, first, Sunflower determined to use the informal competitive bidding technique because it afforded Sunflower the opportunity to receive and evaluate all bids in total and complete secrecy; second, because it could blacklist and exclude Riverside from bidding, without any attempt to investigate Riverside's qualifications and responsibility as a potential bidder; and, third, because it could exclude, at its whim, any bidder for any reason, without prior review by the REA and so that it could avoid having to justify a bidder's exclusion to the REA.

Senator, the transcript references are in my prepared statement and I will just read the testimony from the transcript. I have provided you with a highlighted copy and Mr. Hunter with a highlighted copy.

Senator HAWKINS. Thank you.

Mr. MORTENSON. On the first line, the use of informal bidding procedures, the first question:

*Question.* OK, sir, now with respect to the Mingo to Setab line, could you tell me when the bid packages for the steel were released?

Answer. As I recall, it was approximately October 26th, in that time frame.

*Question.* Now, was that something that Sunflower itself did, or did Burns & McDonnell handle that chore?

Answer. Upon recommendation from my department, Burns & McDonnell sent those out. (And, for the record, Burns & McDonnell were the consulting engineers for Sunflower.)

*Question.* Do you mean on approval by your department?

Answer. After the document was approved by Sunflower's engineering staff, myself putting approval on a transmittal letter to Burns & McDonnell, also approval from the REA in Washington, they were sent out.

*Question.* Now, at that point in time, had a list of prospective bidders been compiled?

Answer. Yes.

*Question.* Who had done that initially?

Answer. The engineering consultants were asked by myself to give a list of all possibilities from that, I selected who I wanted to bid.

*Question.* So Burns & McDonnell came up with a list of all possible bidders for this job. Is that right?

Answer. Yes.

*Question.* Now, this list then that had all of the prospective bidders, did that include every lattice steel tower manufacturer in the United States?

Answer. To my knowledge, yes.

*Question.* Did it include any foreign firms?

Answer. I believe there was at least two foreign firms on that list.

*Question.* So, that there were perhaps six to eight domestic firms at most?

Answer. Possibly, yes.

*Question.* Was Riverside Industries on that list, to your knowledge?

Answer. I believe they were on the large list, large list being the total possible vendors.

*Question.* Were there any domestic fabricators other than Riverside Industries excluded from your final list for reasons other than their lack of a track record in producing a job as large as 2,500 tons of steel?

Answer. I don't believe so.

*Question.* So then, it is your testimony that every domestic manufacturer, other than Riverside Industries, that had the capability of producing 2,500 tons was on your final list?

Answer. To the best of my knowledge, I believe so; yes, sir.

*Question.* All right, sir, when were proposals actually received?

Answer. I believe it was November 18th, 1980.

*Question.* Were there post-proposal negotiations with any of the five bidders?

Answer. No. Post-proposal meaning after the proposals were received?

*Question.* Yes, sir.

Answer. No.

*Question.* Is that a procedure that's allowed by the REA Bulletin 40-6, in connection with this informal bidding arrangement?

Answer. Yes, it is.

*Question.* But none was conducted in this connection?

Answer. None was conducted. 40-6 has a paragraph which indicates basically the owner may elect to negotiate a route of negotiations. I can't quote it. We do have it in the bid documents.

*Question.* Now, in connection with the Mingo to Setab steel procurement, what was the basis for Sunflower's determination to utilize the informal competitive bidding method as compared to the formal competitive bidding method?

Answer. The informal negotiating bid, as it is called, in, I believe, it is the 40-6 Bulletin, gives us a bid opening, which is done in private where we do not disclose price. If she is supplying steel, the only price she will ever know is the price she submitted.

*Question.* OK. And by she, you are just using the court reporter as an example?

Answer. As her steel firm.

*Question.* Why do you do that? Why is that considered better?

Answer. Basically, I feel it gives better pricing.

*Question.* Why?

Answer. I feel that a steel firm who wants the job will, and is invited to bid, will present a, as low a price as he feels he can afford to give, as well as it also gives the owner the ability to evaluate the bid in private, rather than a formal competitive bid, in my mind, implies open, a public bid opening.

*Question.* And why is that not desirable?

Answer. Basically, I feel that in an open bid, in a public—excuse me—in a public bid opening, if everybody that presents a bid knows who else is going to be bidding on that, if one steel firm, one vendor of any material, knows the other bidders, he can, from past history, adjust his price to either get the job or not get the job, and that's my feeling.

*Question.* So, you think everybody in a formal open bidding may submit higher prices?

Answer. Not necessarily, no.

*Question.* So, there is no price advantage one way or the other over the two methods?

Answer. Probably not, no.

*Question.* So, you use this technique just because you want to evaluate the bids in private?

Answer. Yes, we are allowed to, under REA rulings. We can use either procedure.

*Question.* But, that's the reason you do it?

Answer. Yes, and this turns out to be my preference.

*Question.* And Sunflower's preference, therefore?

Answer. I am represented with Sunflower.

*Question.* Is the award of this Mingo to Setab steel procurement subject to REA approval after receipt of proposals?

Answer. Yes, it is.

*Question.* Any exceptions either sought or approved by the REA in connection with, sought by Sunflower or approved by the REA, to the 40–6 requirements?

Answer. To my knowledge, no.

*Question.* When did Sunflower make its original determination to exclude Riverside from the final list of vendors that would be allowed to receive bid invitations?

Answer. Is this in conjunction with the Mingo to Setab?

*Question.* Yes, sir. My questions are in connection with that.

Answer. OK. It would have been prior to the bid packages being sent out.

*Question.* When you say, it was done by telephone conversation, please explain.

Answer. I called the consulting engineer, in this case, Mr. Rodick, and gave him a verbal list of who the bid packages are to be sent to.

*Question.* You just wrote them down, and there was no commentary, one way or the other?

Answer. No. I established the list myself.

*Question.* OK. Can you describe for me the process you went through in deciding on the list?

Answer. I reviewed the bid evaluations on the first segment of steel, and in my mind, I reviewed any comments which I had heard positive or negative about any of the firms.

*Question.* And what did you do in connection with reviewing the bid evaluations?

Answer. Basically, I looked to see what the relative positions as far as the evaluated price was.

*Question.* And what is the purpose of that?

Answer. To determine their relative positions, to see if any of the steel vendors were unusually situated beyond what a grouping, or an average for the evaluated price would have been.

*Question.* And you determined that Riverside should be eliminated because they did, they were unusually situated with regard to pricing versus the other bidders on the State Line to Mingo project?

Answer. That's correct.

*Question.* Why was that a factor in determining whether or not they should be allowed to bid on the Mingo to Setab?

Answer. Because that was a component of my evaluation of who I wanted to bid on the next segment.

*Question.* But, that had nothing to do with whether or not Riverside could perform on the Mingo to Setab line, isn't that correct?

Answer. That's correct.

*Question.* Okay, sir. Now, you said that the other part, if you will, of your process in determining the final list of who would be allowed to receive invitations, was to go over in your mind any comments that you had heard about the various names that were on the master list, is that right?

Answer. That's correct.

*Question.* Now, what did you, in connection with this, look at, any documents?

Answer. To my knowledge, I did not.

*Question.* What meetings were these?

Answer. I have been at various meetings over the past two years: Kansas City, mainly; utility type meetings.

*Question.* Now, any other firms from the master list that were eliminated on the basis of comments, other than considering for the moment, Riverside?

Answer. To the best of my knowledge, no.

*Question.* Now, did comments about Riverside have anything to do with, aside from your process on bid evaluation that you mentioned, aside from that, did comments about Riverside have anything to do with Riverside's elimination from the master list?

Answer. I had heard comments about Riverside.

*Question.* At these meetings?

Answer. Possibly. I don't recall where, but I would say, it was more than likely at these meetings, not as a topic of the meeting, but generally over a cup of coffee, lunch-type busy discussion.

*Question.* When is the most recent meeting of that sort that you have attended?

Answer. I don't recall. It's been two or three months ago.

*Question.* Before or after bids were received on the Mingo to Setab steel?

Answer. I believe it is before.

*Question.* Was it before the end of September?

Answer. I believe it was.

*Question.* What comments did you hear about Riverside at that meeting?

Answer. It is difficult to recall. As I recall, the comment about performance.

*Question.* Well, did you hear any comments about Riverside from the St. Joe representative at any of these meetings?

Answer. I can't recall exactly who I heard comments from.

*Question.* No, sir. My question is, did you hear any comments about Riverside from the St. Joe representative?

Answer. I don't know.

*Question.* How about the Missouri Public Services?

Answer. I don't know.

*Question.* Kansas City Power and Light?

Answer. I don't know.

*Question.* Kansas Power and Light?

Answer. I don't know.

*Question.* Kansas Gas and Electric?

Answer. I don't know.

*Question.* Central Kansas Power?

Answer. I don't know.

*Question.* Central Telephone and Utility?

Answer. I don't know.

*Question.* What were the substance of the comments made to you from someone at those meetings?

Answer. As I recall, the substance of the comments were that there was a problem with performance.

*Question.* Give me your best recollection of what the problem was, and how it was explained to you.

Answer. To the best of my recollection, it would have been a problem with performance of delivering steel on time.

*Question.* Now, had any of the utilities or the people that you heard the comments from, had contracts with Riverside?

Answer. I really don't know.

*Question.* Did you ask them?

Answer. As I recall, I didn't ask them.

*Question.* Did you ask them where they got their information?

Answer. No.

*Question.* Was this more anything more than very casual conversation?

Answer. That's correct. There was nothing more than casual conversation. It was not a topic of the meeting.

*Question.* You either had been involved with the procurement of steel for Sunflower for two to three, or were going to be involved in connection with procurement of steel lattice transmission towers, for two or three segments of line, isn't that right?

Answer. At that point, it would have been two, but that is correct.

*Question.* So, that you had some interest in this topic, that is, who was out there, who could perform steel fabrication for steel lattice transmission towers?

Answer. I would.

*Question.* So, was it a topic that you had more than casual interest in?

Answer. In the context of eating lunch, or a coffee break, possibly, yes.

*Question.* But you can't recall who made any of those comments to you about Riverside?

Answer. No.

*Question.* Can you remember anything else about the substance of those comments?

Answer. No, I can't.

*Question.* Did they tell you what jobs Riverside experienced problems on timely delivery of steel?

Answer. To the best of my knowledge, no.

*Question.* What did you do to verify this informaton?

Answer. In my own mind, at that point, I had—excuse me—let me rephrase it. When I came to the point of evaluating which steel vendors to send bid documents to, that was a component of why I did not send one to Riverside; but, another component was the fact that they were substantially higher on evaluated cost on the first.

*Question.* What you mentioned earlier?

Answer. That's what I mentioned earlier.

*Question.* OK, sir. My question is, after you heard these comments about Riverside, what did you do to verify their comments?

Answer. At that point, nothing.

*Question.* Up to the point of October 26, when you gave the list to Mr. Rodick, at Burns & McDonnell of those that would be allowed to bid, did you do anything to verify that information?

Answer. No.

*Question.* Did anyone else at Sunflower, to your knowledge?

Answer. To my knowledge, no.

*Question.* What other investigation, if any, did you undertake about eliminating Riverside, other than the two steps that you have mentioned?

Answer. That was all the investigation we did. That was all the investigation I did.

*Question.* OK, sir. What other investigation did Sunflower do?

Answer. None.

*Question.* Are you aware of any other documents that evidence under Sunflower's decision to withhold pre-qualification of Riverside?

Answer. To my knowledge, no.

*Question.* All of that occurred, in your mind, is that right?

Answer. Yes.

*Question.* Is anybody else involved in actually making the decisions to withhold pre-qualification, other than yourself?

Answer. No.

*Question.* Now, had you let Riverside be on the bidders' list, is there any reason why Sunflower would have had to actually award the contract to Riverside if it had later determined after the bid submission that Riverside was not a responsible supplier?

Answer. Repeat that. I believe I understand, but I need it repeated.

(The pending question was read back by the reporter.)

Answer. No.

*Question.* So there is a mechanism under REA procedures that Sunflower would be allowed to pursue investigation as to Riverside's responsibility as a steel supplier after bid submission?

Answer. Yes.

*Question.* But you didn't follow that in this case?

Answer. In this case, no.

*Question.* Why?

Answer. If you accept a bidder as an integral member after bid list, put them on a bid list, receive bids, and later determine there is some point at which you want to disqualify them, it becomes very difficult to reject a bid without an extremely detailed explanation, even verbal, to REA.

*Question.* So in the event you had let Riverside bid, and in the event they happened to be the lower bidder, then it would have been a more involved process to not go ahead and award the contract to them?

Answer. It would have, yes. It would have further complicated the total project.

*Question.* And you would have had to justify your rejection of Riverside's bid to the REA?

Answer. Yes.

*Question.* But you didn't have to do that by leaving them off the bidders' list?

Answer. That's correct.

Turning to page 145 and referring to Mr. Parrish's testimony, who was then President of Riverside,

*Question.* What did you tell Mr. Parrish in the telephone conversation?

Answer. As I recall, Mr. Parrish was not satisfied with the fact that his firm's name and reputation could be damaged in a bid opening of ours, and as I recall, I got the impression we were having a public bid opening where everybody apparently would have been invited to bid. I attempted to correct that thought, and informed him that it was not a public bid opening, that if a particular firm was invited to submit a bid, they would only know their own figures, and that they would not even be aware of what other firms would be bidding.

*Question.* You mean the other firms wouldn't know the numbers?

Answer. They would not know the dollars that the other vendors would be submitting.

*Question.* OK. But the other vendors would know who was allowed to bid, and who wasn't?

Answer. I don't know as we have ever allowed that, ever kept that secret.

*Question.* So, your answer is yes, is that right?

Answer. I don't make a practice of telling everybody all of the bidders.

*Question.* Did Mr. Parrish raise the point with you that even if you let Riverside bid, you wouldn't necessarily have to award the contract to Riverside in the event subsequent investigation revealed Riverside not to be a responsible bidder?

Answer. I believe so.

*Question.* How did you respond to that?

Answer. I believe I held the position that we had made the decision not to allow them, and reaffirmed it.

*Question.* And that relates to your testimony earlier today about it being more complicated to not award a contract to an apparent low bidder whom you don't want to award to?

Answer. I believe so, yes.

Mr. MORTENSON. The fact is, Senator Hawkins, that we think this is a documented example of the abuse and prejudicial treatment that can arise under existing REA procurement procedures. This example goes only to abuse before bids are received. But it takes very little imagination to see what can happen after the bids are received in secret and without the benefit of the valuable checks and balances of open, public competitive bidding.

Incidentally, I should note for the record that subsequent effort by Congressman James Jones, of Oklahoma, to arouse the REA over this example has fallen on deaf ears. By letter to Congressman Jones on May 27 of this year, Mr. Joseph Zoller, Acting REA Administrator, concluded:

> While we can understand your concern over the fact that your constituent, Riverside Industries, has not been invited to bid on a certain REA-financed project, REA, nonetheless, continues to believe that the policy set forth in Bulletin 40–6 of allowing borrowers to be responsible for which bidder should be permitted to bid, as long as adequate competition is maintained, best serves the interest of the government and the cooperatives.

Riverside is also aware of another—and perhaps even more egregious example of abuse of negotiated procurement by an REA-funded utility—involving a contract for construction amounting to well over $20 million, which was negotiated by the REA borrower, without prior, necessary REA approval. In fact, when after the fact REA approval of the excessively expensive, negotiated contract was sought, it was sought and obtained by concealing from the REA that the borrower's own consulting engineer had advised it that it could have obtained competitive bids in less than 2 weeks and that, in the engineer's opinion, the price so obtained would have been lower.

Moreover, Senator Hawkins, I can tell you the documents relating to the REA approval in that case were erroneously dated to indicate that REA approval of negotiations had occurred before the fact when in actual fact, approval was sought after agreement had been reached with the contractor.

In the limited time today, I am unable to detail this example to the subcommittee. It is, however, documented and available to the staff, and I am willing to work with the staff, the General Accounting Office, and the Administrator of the REA, to investigate these matters further and fully. I urge them to respond.

The bottom line is that current REA procedures for material and construction procurement for Government-financed or guaranteed projects are antithetical to fair and open competition by all qualified bidders and invite abuse by REA-supported borrowers. Moreover, if the instances of which I am aware are any example, REA surveillance of the abuse of existing practices by its borrowers is inadequate and careless, at best.

Because there is a suggestion in some court decisions that potential bidders on REA projects who have been arbitrarily excluded from the competitive process have no standing to challenge an REA borrower's decision in court, it is essential that REA-sanctioned procurement methods be restructured. I urge the Congress to investigate these matters fully and take whatever steps are necessary to ensure fair and open public bidding on federally supported procurements by REA borrowers.

The subcommittee will again shortly hear from the new REA Administrator, Harold Hunter. I urge him not to look for reasons why the REA should not require fair and open competitive bidding by its borrowers. Rather, I hope that he embarks on his new job by committing to this subcommittee that he will investigate the specific matters I have mentioned and that future REA policy will mandate public competitive bidding by REA borrowers in all cases except those of an extraordinary emergency. REA clearly has reserved the power in its loan contracts to require fair and open procurement procedures. Congress should direct the REA to exercise that authority.

I would like to thank the Chair and subcommittee for its time and attention today. With the permission of the Chair, Riverside would like to reserve the right to submit a supplemental statement to the subcommittee in writing, due to the short time we had to prepare for this.

Senator HAWKINS. Thank you, Mr. Mortenson. We really appreciate your coming today on short notice. And I know that the Administrator, as well as the members of this subcommittee, will read carefully your statements and your further statements. Your experiences are very valuable to this inquiry.

In your opinion, what other guidelines should the REA give co-op management as to who should receive a bid package, other than "make it competitive"?

Mr. MORTENSON. Senator, I think the answer to that is that the prevalent practice ought to be public competitive bidding where the qualification and responsibility determination is made after bid submission rather than before, that is, that procurements would be publicly announced in some form, such as through the Federal Register; that any bidder would be allowed to submit a bid to the co-op, and that a responsibility investigation with standards articulated for what matters are to be looked into be conducted after submission of the bids for the low bidder rather than putting it as a matter to be determined before bid packages are sent out.

And if it is left that the responsibility determination is to be made in advance, then there ought to be articulated procedures by the REA as to what matters they will consider with a requirement that they will do a real investigation of responsibility rather than a sham.

Senator HAWKINS. In your opinion, why did REA give co-ops this informal bidding option in the first place?

Mr. MORTENSON. Senator, I don't know. Formal competitive public bidding is a precept that is just grounded in all publicly supported procurements. I am sure that they wanted to give the co-ops as much flexibility as they could possibly allow them to have, and I am sure the intent was good. But based on the examples that

I have seen—which aren't very many, but, nevertheless, they're bad examples—I would suggest that that system is not working and that there needs to be a new examination made.

Senator HAWKINS. I would say that most of us, within the sound of your voice, agree today. Mr. Mortenson, we do thank you for coming, and we would ask that you continue to be available for future hearings. We promise you there will be more hearings.

Mr. MORTENSON. Thank you very much, Senator.

Mr. Hunter has been with us throughout the hearing. I understand you have John Holt with you, who is chief of your power plants branch in the Power Supply Division. Is that correct?

Mr. HUNTER. That is right, and several other members of our staff.

Senator HAWKINS. For the record, Alexander Sherman, chief of the transmission branch, as well as Frank Bennett, director of the Power Supply Division.

Mr. HUNTER. And Don Olsen, who is the assistant administrator of the electric program.

Senator HAWKINS. Mr. Hunter, I am sure you know the impetus behind us here, and you have been informed of the situation that arose at Seminole Electric Co-op. Could you tell me what you know about the Seminole investigation at this point?

Mr. HUNTER. Well, Senator, I would like to explain that these matters are things that were reported by the press, and from experience, should be discounted to a considerable degree.

As far as our relationship as a lender to Seminole, we have utilized the normal precautions. And I think probably it would be improper for me to comment in any detail on that situation since it is under investigation. Of course, we are looking forward to the time that we can have a better understanding as to all of the details relating to that, based upon the information that might come from the investigation that is ongoing at the present time.

Senator HAWKINS. With the OIG?

Mr. HUNTER. Yes.

Senator HAWKINS. Did anyone in your agency, to your knowledge, review the Seminole contracts that are under scrutiny before they were awarded by the Seminole board of directors?

Mr. HUNTER. I am certain that is true. And I would refer to Mr. Bennett and let him indicate if you wish.

Senator HAWKINS. Mr. Bennett, do you know if anyone at REA in Washington reviewed those contracts?

Mr. BENNETT. Senator, could you identify the contracts? We have literally dozens and dozens of contracts with Seminole. Are you talking about any particular one that we can zero in on?

Senator HAWKINS. The coal contract.

Mr. BENNETT. The coal contract?

Senator HAWKINS. Yes.

Mr. BENNETT. The coal contract was reviewed at REA.

Senator HAWKINS. What was the amount of that coal contract? Do you remember?

Mr. BENNETT. No; I don't.

Senator HAWKINS. Could you agree, subject to check, $1.8 billion?

Mr. BENNETT. That wouldn't surprise me.

Senator HAWKINS. That does not surprise you for a co-op the size of Seminole?

Mr. BENNETT. Not for a long-term contract.

Senator HAWKINS. And do you know who had the responsibility for reviewing the coal contract?

Mr. BENNETT. Well, at the time——

Senator HAWKINS. Is it a committee or is it one man?

Mr. BENNETT. In the Seminole organization, the Seminole professional consultants, the Seminole board of directors, all have a degree of responsibility to reviewing the contract. The contract was approved by the Seminole board.

Senator HAWKINS. The Seminole board, with the approval of your agency?

Mr. BENNETT. Yes.

Senator HAWKINS. And you feel that Seminole used prudent business procedures?

Mr. BENNETT. Yes.

Senator HAWKINS. Mr. Hunter, is it true that the REA, has reduced the number of contracts for projects that require REA approval and review?

Mr. HUNTER. That is correct.

Senator HAWKINS. What were the reasons for that decision or was that before you became Administrator?

Mr. HUNTER. It was before I came. However, I do understand the reasoning, and it relates to the maturing of the companies, the co-ops, that we are dealing with. The fact that they have reached a greater degree of sophistication, with a greater amount of staff support, people who can provide them the types of certification which should be normally accepted within most business entities and business relationships.

The fact also that they do use expert consultant services, which again are the type to maintain integrity and are normally accepted in business circles.

Senator HAWKINS. How does your staff make a decision which contracts should be reviewed in detail and which should not?

Mr. HUNTER. I am going to, again, relate it to staff, but my impression is that these are pretty well delineated within our procedure, which run through the usual rulemaking process and which have been exposed to usage for several years. But, again, since we are talking about the power supply areas most generally, I will ask Frank Bennett to respond to that, too, if I may.

Senator HAWKINS. Mr. Bennett?

Mr. BENNETT. Senator, we decided that we could best improve our position by focusing in on those contracts which represented the most dollar components of the construction of any major generating facility. These 10 to 12 contracts are specified in REA Bulletin 40–6. The basic reason they were specified—the turbines, the boilers, precipitators, and other items of this nature, including the building contract, are the ones that are most integral to the success of the operation and represents by far the major dollar components. We say 12 contracts represent 75 percent of the construction dollar.

Senator HAWKINS. Who is responsible for the review of co-op powerplant construction contracts?

Mr. BENNETT. At Seminole or at REA.

Senator HAWKINS. At REA.

Mr. BENNETT. At REA, the contracts are handled within the powerplants branch of the Power Supply Division.

Senator HAWKINS. Is there a man's name there?

Mr. BENNETT. John Holt.

Senator HAWKINS. John Holt? And he is responsible for the powerplant construction contract?

Mr. BENNETT. At REA, yes.

Senator HAWKINS. What about the transmission contract?

Mr. BENNETT. The transmission contracts are handled by Alexander Sherman, who is the chief of the transmission branch of the Power Supply Division.

Senator HAWKINS. The fuel supply contract?

Mr. BENNETT. Fuel supply contracts are the basic responsibility of the power systems specialist that we have in the Power Supply Division. Assisting the power supply specialist, we have Bill Telaar, who has been REA's fuel expert for many years.

Senator HAWKINS. He is the fuel expert?

Mr. BENNETT. Yes.

Senator HAWKINS. I believe he is on vacation today. Is that correct?

Mr. BENNETT. Yes, he is.

Senator HAWKINS. A good day to be gone, isn't it? We will ask him to testify at a subsequent hearing. Does Mr. Telaar review all of the fuel contracts presented to REA?

Mr. BENNETT. If the power systems specialist believes that he should, a request would be made for his expertise and his knowledge. They would seek his advice and his assistance in the review and approval process of that contract. If the power systems specialist wanted to rely on their own expertise they would conduct the REA review.

Senator HAWKINS. Thank you.

Mr. Hunter, do you know—I know you are the new Administrator—why was the 40-6 Bulletin revised to allow the use of informal bidding procedures?

Mr. HUNTER. Well, again, I think it fits very well with the direction that we find our present administration pursuing, and that is that there is sometimes an overburdening of any industry with excessive regulations, and this was an effort to respond to the fact that there was great capability within our borrower to pursue some of the details of this type of activity, and to do it in a way that could be accepted as being credible. So this I think is the general direction that was pursued, based on the idea that somewhere a line needs to be drawn between those things that actually have to be looked at carefully on the basis of further review and which of those things can be the responsibility of the borrower.

I think we need to remember that the borrowers are independent entities with a responsibility of their own. We at REA do not act as a regulatory body. Our responsibility certainly is to pursue those things and to review those things which will assure us of having protected the taxpayers' interest in the investment and the support that we do give through the financing and the loan procedure to provide capitalization to these borrowers.

Senator HAWKINS. Do you feel that the individual consumers of REA electricity would be surprised to find out that informal bidding is allowed?

Mr. HUNTER. Well, as we heard the discussion of the informal bidding practice that was criticized some while ago, I notice that in some of the material which was not read—some of the testimony which was not read—the reference was made to the fact that there were several bidders who were allowed to bid. And certainly it appears to me that there cannot be too great a criticism if there is a relatively good number of acceptable bidders, responsible bidders, who do bid, that then the responsibility on the part of the REA to assure that a competitive attitude or a competitive atmosphere is attained, that this then has been achieved.

And I beg forgiveness for perhaps being argumentative, but I think this is pertinent to what we are discussing. Our responsibility, if it can be met under the regulations we have at the present time of an informal competitive bidding procedure does provide the competitive aspect which does protect the interest of REA as an investor and of the taxpayer who has provided the money. It would seem that we have met our responsibility.

I am not arguing that this should not be looked at further. I am not saying that we should not constantly review the procedures that are used. But it seems to me that this is one of the ways to measure whether or not that procedure is acceptable and should be continued.

Senator HAWKINS. Does 40-6 require a co-op to use open competitive bidding on any of its contracts?

Mr. HUNTER. I am going to turn again to staff on that. Mr. Bennett, I know you could answer that easily.

Mr. BENNETT. No; it does not require it.

Senator HAWKINS. On any of its contracts?

Mr. BENNETT. No.

Senator HAWKINS. Then am I correct in thinking that 40-6 does not apply to fuel supply contracts?

Mr. HUNTER. Not as a mandatory exclusive way of bidding.

Senator HAWKINS. Are there any written policy guidelines developed by REA for co-ops to follow the negotiations for their fuel supply contracts?

Mr. HUNTER. Frank?

Mr. BENNETT. No. We find the fuel contract is not of the same type as buying 1,000 feet of wire or 100,000 feet of conductors. There are so many different aspects of the coal contract, fuel contract, and it is most difficult to try to set a standard pattern.

Senator HAWKINS. Does your Power Supply Division review all co-op fuel supply contract proposals?

Mr. HUNTER. I believe they do not review all because, again, they fall within different categories and different degrees of responsibility.

Senator HAWKINS. How do you select which ones to review?

Mr. BENNETT. It would be on the basis of the degree of importance of the contracts.

Senator HAWKINS. The amount of money, or tonnage, or what?

Mr. BENNETT. The degree to which the success of the power supply plan depends on the adequacy of the fuel contract. Obvious-

ly, if you plan that a powerplant has a mine mouth source of fuel, you need to have a contract with that mine, or you have lost the advantages of where you locate the plant. In that case, we would insist that the contract be reviewed by REA.

In arrangements where coal has to be of a certain quality, or low sulphur, or other types of chemical compositions to meet the environmental requirements of the plant, we ascertain that that quality of coal is available. And, there again, we insist that we review the contract before the plans proceed.

Senator HAWKINS. Is it true that every REA loan contract for powerplant construction, materials, and equipment requires that the co-op appoint an architectural engineer to make onsite inspections to make sure that REA-approved specs have been followed?

Mr. BENNETT. Basically, yes.

Senator HAWKINS. I believe this contract described in REA Bulletin 80–11, which requires that the borrowers' architects make periodic progress reports.

Mr. HUNTER. Yes.

Senator HAWKINS. Does the REA loan contract for the purchase of fuel, such as coal, have a corresponding requirement for the appointment of an engineer to do onsite inspections to determine that specifications approved by your power division has been followed?

Mr. HUNTER. I believe not.

Mr. BENNETT. No.

Senator HAWKINS. Does anyone ever inspect the actual site where the coal is delivered or fuel is delivered?

Mr. OLSEN. Are you referring again to the REA staff or the cooperative?

Senator HAWKINS. The REA staff.

Mr. OLSEN. At any time the staff is onsite they would also review the fuel received and the facilities where coal would be stored.

Mr. HUNTER. I believe that normally an audit would address itself to the volume of coal that was onsite also, would it not?

Mr. OLSEN. Yes. The audit is also an after the fact report as to the amount of fuel burned.

Senator HAWKINS. Do coal and limestone contracts fall into the same category?

Mr. BENNETT. In my judgment, no.

Senator HAWKINS. Why would you say that?

Mr. BENNETT. Limestone contracts are not the same as coal. There are not as many dollars involved in limestone contracts as there are in coal contracts. Basically, REA does not approve limestone contracts.

Senator HAWKINS. REA does not approve limestone contracts?

Mr. BENNETT. That is right.

Senator HAWKINS. Do other Federal lending agencies that deal with borrowers who purchase construction material and power have onsite auditing procedures in place to prevent waste and fraudulent use of loan, to your knowledge?

Mr. HUNTER. Well, I would hesitate to comment on what all other Federal agencies may do as far as their policing or monitoring activities are concerned. So I would not know, and I don't know

whether any of our staff would know or not. Any comments would be appropriate. This is a little bit beyond our knowledge.

Senator HAWKINS. So you don't know?

Mr. HUNTER. No, ma'am.

Senator HAWKINS. Do you have engineers working for REA in the field?

Mr. HUNTER. Yes; we do.

Senator HAWKINS. What is their responsibility?

Mr. HUNTER. Well, they work with the borrowers in the preparation of loan applications, and they also make visits to the borrowers as to the ongoing activities of the borrower and a protection for the investment which is made by the REA.

Senator HAWKINS. I know you are new on the job, Mr. Hunter, and this is a subject that I feel is long overdue discussing in light of the REA getting into G. & T., generating and transmission, and coal purchasing, which amounts in some contracts to billions and billions of dollars.

In light of the testimony you have heard here today, and knowing that we are going to have ongoing discussions and review of especially 40–6, do you feel that your agency has the responsibility of giving us suggestions or promulgating new bidding contract review, et cetera, so that you can better monitor the use of the tremendous amount of money that is used by the REA's and is paid for by the taxpayers as well as the ratepayers?

Mr. HUNTER. Certainly, I cannot disregard or can I disagree with what you are saying, that the volume with the moneys involved are such that we need to exercise every caution and every amount of review that we can possibly do to make sure that the investment on the part of the Federal Government and the taxpayer is protected. And we are certainly in the process, even now, of looking at what changes can be made. This is an ongoing process of review and discussions. And we would certainly be receptive to anything that does surface from the studies that have been made and are being made here today and will be made in the future in similar hearings.

We are aware of the magnitude of this responsibility and do take it very seriously, and do desire to respond every way that we can.

Senator HAWKINS. I know that you are a former bank director. Is that not true?

Mr. HUNTER. That is right.

Senator HAWKINS. And in light of the many statements that have been made today—and I have just written down several—for example, that the current REA procurement procedures for materials and constructions create arbitrary, capricious, and prejudicial treatment of suppliers. That secrecy brings abuse and prejudicial treatment; that, indeed, there are prudent business practices, as defined in the real business world, which should be followed by all. These are the questions we have and will continue to look into.

It seems to me that the most disturbing things we have heard in the testimony today is that not only were prudent business practices not followed, but even shoddy business practices may be being followed. And I get a feeling that they are acceptable under the current REA requirements. And I can understand your concern over waste, fraud, and abuse, a platform which our administration

ran on. And I would say that I support less paperwork and less regulation, where the marketplace is with competition, but where the marketplace has no competition, as in a monopoly, and where you are charged with delivering a life support service some degree of regulation may be necessary. Electricity is, in my mind, a life support service, and should be delivered at the least possible cost, especially under the REA where Federal funds are used.

I appreciate the original concept of the members being the stockholders, if you will, of REA in contrast to investors in an investor-owned utility. It appears that the companies—REA companies—as well as the agency's integrity is being questioned by not only the case in Florida but all over the country. I think we have learned here today that we are just touching the tip of the iceberg, and the case in Florida is not the only case of its kind in the United States. Now that the REA's are involved in generating and transmitting tremendously large systems that cross State lines, it seems to me that we must—all of us—look at 40-6, the bulletin which was initially written to reduce paperwork, but which may have invited abuse and very little regulation or review of billions of dollars.

As a former public service commissioner in Florida. I am concerned and alarmed by the reports that I am reading in Florida, We have heard about examples in Oklahoma, and I am sure that you are aware of those—Texas, Kansas, Alabama, Minnesota, Illinois, Virginia, and other States—that graphically depict a need for continuing investigation by this subcommittee.

And I have talked with other Members of Congress, who are busy right now cutting the budget, cutting taxes, indeed trying to bring about a more prudent quality to our decisionmaking process. And it seems to me really ironic that we are in this day and age having to revisit the original concept of delivering life support service to the rural areas.

Yesterday, I heard a case of a family that only just received electricity as late as 1976. There still are areas where they are 24 miles from the mailbox and 48 miles from their next door neighbor, and they are delighted to be receiving electricity.

There is also a conflict in my mind that in some areas of the United States where the density is absolutely phenomenal that these areas are still being served by rural electric co-ops. Possibly you should also review at what point in time an area no longer is rural because density is indeed part of the formula which helps determine whether a service area should be utilizing Federal money.

I don't think the rural electric co-ops can be acting in the best interest of rural America until they use competitive bidding. And I think in today's real world where everything is subject to view and review, that maybe your agency, under your new direction, would be willing to go back and review their past practices and to bring about some reform in this area. I personally would not want to be individually responsible over at your agency as the coal czar or the energy czar. That responsibility needs to be, in my mind, spread out to more experts and more responsibility given to those who are indeed experienced in this business.

It has become a more complicated business than it was before we allowed REA's to go into generating and transmitting. I think we

should have probably reviewed a lot of the rules that go along with that. So I am looking forward to working with you, and the other members of this subcommittee and with Members of Congress. Several Congressmen are interested in the same question. And we would like to thank those people who came here today.

I will tell you that some of them traveled a long way. I hope they won't be put on any no bid list by the REA or blacklisted by any agency or any company because they came at my request. And we have other witnesses who would have been here today and who will be here at our next hearing. And I would like to assure you, Mr. Hunter, that we are here to help you.

Mr. HUNTER. Senator, I appreciate the remarks you have made, and certainly would not take issue with any of them. I think, in the same breath, that we need to be very careful as we look at the charge, and the legal and the statutory responsibility that has been laid to REA, that we remember that REA, at least at the present time, is not charged with regulatory responsibilities. It is charged with the responsibility to guard the investment that has been made by REA, perhaps as a banker. You made reference to the relationship to banking. And certainly there is a relationship there. But that situation does involve the process of overview that may be lacking in some cases. And if it is, we want to find out about it, and we want to change our processes in such a way that we can correct for that ineptitude on our part if it does exist.

In the same breath, we need to recognize again that we need to stay away, if we can, from any unnecessary responsiveness that we might demand, which would become an excessive burden upon the part of what was provided to those borrowers, because the old excessive burdens can also result in excessive rates that would add to the cost that are accrued out there in that borrowers operation.

So certainly the suggestion that out of this we have heard some things today that we certainly need to review, that we need to explore, and that in the further process of this subcommittee we will also perhaps learn further things that we need to look at. We have already seen enough, that certainly we are going to look at the regulations that we at the present time do have.

I would hope that the statutory responsibilities of this agency are not changed to include the area of "regulation" as opposed to a very proper area of overview that certainly we have at this time as a responsibility, and that responsibility entails making sure that we do have a process of bidding that does entail the hearing of enough presentations and enough proposals that our borrower out there has had the opportunity to receive the needed services and the needed material at the lowest bid and under a competitive fashion.

Senator HAWKINS. I would also like you to look into the election of the directors, the practices that are followed, if necessary, State by State. As you know, we conducted this hearing, using our personal staff. We did not use any of the Agriculture Committee staff, which is usually available to a Senator. And having a number of people work for you compared with the number that work for me, I would like that information provided to us. The case in Florida brought this entire matter to my attention and I believe we should hold hearings throughout the country which I intend to do.

The subcommittee will hold hearings on the bidding practices and election practices throughout the country to get a flavor of other areas. But we felt the first one should be held here with you, as the new Administrator. And it may be that in following meetings that we have, you will bring a list of recommendations to us on which we will hold further hearings on these new regulations that you feel may be more valid in today's world.

We thank you for your cooperation and all of those participated today. The hearing is closed.

Mr. HUNTER. Thank you, Senator.

[Whereupon, at 11:59 a.m., the subcommittee adjourned, subject to the call of the Chair.]

# APPENDIX

STATEMENT OF HON. HAROLD V. HUNTER, ADMINISTRATOR, RURAL ELECTRIFICATION ADMINISTRATION

First Senator Hawkins, let me say that REA welcomes this opportunity to discuss the administration of its loan program with you. Let me take a minute to detail the magnitude of the electric program. In the fiscal year that just ended, REA approved loans totaling $850 million under the insured loan program and almost $5 billion under the guaranteed loan program. These loans went to 354 distribution cooperatives and to 33 generation and transmission cooperatives. The insured loan funds basically at 5 percent interest rate, with some loans at the mandated 2-percent interest rate, will come from the Rural Electric and Telephone Revolving Fund, while the guaranteed loan funds will basically come from the Federal Financing Bank under a standing agreement that REA has with the Bank. In the 46 years since the inception of the REA loan program, over $42 billion has been loaned or guaranteed. Of this total, only some $44,000 has been written off as a loss.

First, let me discuss the area of bidding and purchasing procedures.

Certainly the administration of a loan program of this size demands a certain degree of oversight and monitoring by REA. This is especially true in the area of how REA borrowers spend these loan and loan guarantee funds to build the distribution and generation systems necessary to deliver electricity to the rural consumers of this nation. The "Loan Contracts" entered into between the United States of America and a given borrower have always provided REA the right to approve all contracts entered into by the borrower for the construction of any portion of its system, or for any engineering or other services pertaining to the construction or operation of the system.

REA has set forth its policy regarding its relationship with its borrowers in REA Bulletin 2-1, "Guiding Statement of REA Policy Concerning Its Relationship with Borrowers." Let me briefly quote to you from this bulletin.

"Policy: To achieve program objectives and to protect loan security, REA will in its relationship with borrowers, base its activities on the following considerations:

A. That each borrower is:

1. an independent corporate body subject to all applicable laws and regulations;

2. responsible for the efficient and effective management of its own affairs, including proper and successful construction and operation of its system; and

3. expected to repay all indebtedness on or ahead of schedule according to the terms of its loan(s) and established policy."

There are six additional considerations outlining REA's relationship with its borrowers in this bulletin; however, I do not feel it is necessary to cite them at this time.

REA over the years has vigorously adhered to this stated policy through the development of a series of implementing bulletins. These bulletins provide the REA borrowers with the broadest possible latitude in carrying out their own affairs; while at the same time providing REA the proper controls and "approving authority" necessary to ensure that the Government's interest is adequately protected and that the benefits of the REA program are truly delivered to the eligible rural consumers. One such bulletin deals with the area of purchasing of materials and utility plant construction. This is REA Bulletin 40-6 "Construction Methods and Purchase of Materials and Equipment," which outlines general requirements and procedures in connection with new construction and additions to plant.

REA believes that the bidding and purchasing procedures detailed in our bulletins are based upon sound well established business principles and have been well accepted throughout the utility industry. These procedures have been in existence for many years and have withstood the test of time, and in our judgement result in the procurement of needed goods and service at the lowest possible cost. Additionally they provide for widespread competition. REA borrowers are considered to be private entities, and as such are not subject to the Federal procurement regulations.

Let me now discuss the major provisions of REA Bulletin 40-6.

First, the method of construction to be utilized in building transmission and distribution facilities—either force account, utilizing the borrower's own personnel, or employment of an outside contractor, although subject to administrative approval—is usually left up to the borrower to determine. When the employment of an outside contractor is deemed the best method to use in constructing the facilities, certain mandatory procedures must be followed.

REA has developed a set of standard contract forms covering construction specification, professional services, and purchase orders for the borrowers to utilize in carrying out these functions. The use of these standard forms for certain routine distribution construction practices utilizing REA specification and material standards does not require prior REA approval by the borrowers. However, other standard contract forms do require REA approval before they become effective. These generally deal with the more complicated phases of utility system construction such as transmission and substation erection whether performed by generation and transmission systems or by distribution systems.

With respect to generating plant construction, REA requires approval of approximately 12 major contracts associated with the construction of a major power plant. These 12 major contracts out of the approximately 100 contracts associated with the many construction phases of a major generating facility represent approximately 75 percent of the entire construction cost of the generating plant. For the smaller contracts the REA contract forms are utilized without requiring REA approval.

With respect to the purchase of materials necessary for the operation of a generating plant, such as boiler fuel (oil, gas, coal, nuclear fuel) limestone, etc., and related transportation contracts, REA has, as previously stated, the right to approve any of these types of contracts. However, as the REA borrowers have matured and demonstrated their capability to effectively and efficiently acquire these commodities necessary to operate a generating station, REA has reduced its approval requirements and with few exceptions returned this function to the individual borrowers. This is in keeping with the "REA Policy" I previously cited. The REA borrowers generally discuss the contract terms and conditions with REA personnel prior to entering into any contract for the purchase and transportation of these commodities. REA has in the past and will continue in the future to require certain of these major commodity and transportation contracts be made subject to REA approval. This approval will be required in those instances where an REA borrower is obtaining these commodities for the first time, or where the obtaining of these commodities is essential to the successful operation of a major generating plant financed through an REA loan guarantee. Of course in those few instances where REA has provided loan guarantee funds for the development of coal mines, REA approval of coal supply agreements are required.

Bulletin 40-6 provides for the construction of facilities and the purchase of materials under different bidding procedures. These bidding procedures can be summarized as follows:

Formal competitive bidding,
Information competitive bidding, and
Negotiated bidding.

Prior to utilizing any of these bidding procedures, it is the responsibility of the borrower, and its consulting engineer, to first determine what contractors or suppliers are qualified to perform or supply the services desired; and second, to establish a bidder's list of a sufficient number of qualified contractors or suppliers to ensure a true competitive bid situation. (REA recommendations that a sufficient number of firms be invited to bid, to ensure that as a minimum at least three bids will be received). It is also the borrower's responsibility, in concert with its consulting engineer, to "assure that all bidders are treated fairly and no bidder is placed in an advantageous or disadvantageous position with respect to the other bidders, and that the advantages of the competitive system of bidding are maintained for all . . ."

Let me now briefly discuss each of these various acceptable bidding procedures in more detail.

### FORMAL COMPETITIVE BIDDING

Bidding under this procedure requires that a sealed bid be submitted in response to the invitation to bid. This sealed bid is to be publicly opened and read at a specified time and place. Bids are examined upon opening to determine if they are responsive to the invitation and met all major specified requirements of the contract, such as terms and conditions, bid bonds, properly executed, no exceptions etc. Non responsive bids are returned to the bidder unread. The contract is awarded to the lowest evaluated responsive bidder.

INFORMAL COMPETITIVE BIDDING

Under this procedure, sealed bids must be delivered by a prescribed time and place. The bids are opened in private. All bidders are aware that one round of negotiations is permitted to clarify proposals. Bidders are permitted to alter prices during this one round of negotiations. Pricing data of one bidder is not revealed to other bidders during these negotiations. Acceptable bids must be responsive to the bid documents, and the contract is awarded to the lowest evaluated responsive bidder.

NEGOTIATED BIDDING

Under this procedure, unlimited negotiations between the bidder and the REA borrower are permitted. Pricing data revealed by any bidder is not to be used to bargain with or be devulged to other bidders. The contract should be awarded on the basis of the lowest evaluated bid. Negotiated contracting procedures are almost always required in obtaining acceptable commodities and transportation contracts.

REA over the years has developed its bidding and contracting procedures to expressly accommodate the "REA Policy" I previously stated. These procedures allow the REA borrowers to act as independent consumer-owned local entities; while providing the United States Government sufficient controls to properly oversee how the funds provided through the various REA lending programs are used. A measure of this balance between rigid REA controls and local independent stewardship is demonstrated in the amount of contracts requiring REA approval in the construction of a major generating station. As we all know electrical generating stations being constructed today can run well over $1 billion. By reducing the number of contracts requiring approval from approximately 100 to just 12 major component contracts, representing 75 percent of the cost of the plant, REA provides this balance between regulation and independence. REA is proud of the relationship and respect it has earned over the last 45 years in the utility industry—from not only other segments of the industry but from utility contractors and suppliers alike.

Now, let me discuss some relationships between REA and distribution cooperative boards of directors.

The legal basis for the cooperative's business is set forth in its Articles of Incorporation. Another important legal document having a direct bearing on the cooperative operation is its bylaws. These documents set forth the rights of the members and the duties and responsibilities of its officers and board members.

REA has a set of Model Act Bylaws; these bylaws are recommended for cooperatives' use, but are not required. However, all of the provisions of the Model Act Bylaws may not be applicable to a specific system due to state statutes and other requirements.

The board is the body responsible to the members for cooperative management. Except for the specific duties given to officers, each director shoulders an equal responsibility for the conduct of cooperative affairs.

As previously stated, REA conducts its relationships with the cooperative on the basis that it is an independent corporate body subject to all applicable laws and regulations. REA establishes terms and conditions in its loan security documents and policies and procedures to assure the proper implementation of RE Act objectives. We encourage the active participation of members in the affairs of their organization to assure maximum benefits to themselves and to the development of their rural communities.

The cooperative's board is primarily responsible for policymaking, for planning, for exercising financial control, for reviewing the execution of policies and plans, and for charting the cooperative's course. Individual board members should inform themselves about the principles on which cooperatives are based, on why and how their own cooperative was organized, its organization and operational problems, and the status of its assets, reserves and financial integrity.

REA's activities are carried on in a manner to help develop the resources and ability of borrowers to meet their needs, handle their own affairs effectively, and achieve as soon as possible the internal strength and soundness to assure their success as an independent enterprise. It is our intent that, as borrowers develop this capability, direct REA assistance will diminsh accordingly.

REA provides the borrowers with guidelines and recommendations for the nomination and election of a cooperative's board of directors. REA Bulletin 101-5, Model Act Bylaws, recommends suggested procedures for the nominating and election process of the boards, including secret ballot elections as follows: "The persons named as board members in the articles of incorporation shall compose the board until the first annual meeting or until their successors shall have been elected and shall have qualified. Members of the board shall be elected by secret ballot at each

annual meeting of the members beginning with the year 19—— by and from the members to serve until the next annual meeting of the members or until their successors shall have been elected and qualified."

REA's Bulletin 101-4, the Annual Meeting Guide, includes further recommendations as to nomination and election procedures. The bulletin recommends that nominations may be by committee and from the floor. It states that at least two candidates should be nominated for each open board position.

In addition to these recommendations, prior to district meetings or the meeting of the nominating committee, REA requires that cooperatives annually notify their members of the provisions of the bylaws pertaining to membership requirements, annual meetings, board representation, nomination and procedures for election to the board.

REA is not a regulatory body, nor should it be. The question of how much and what type of regulation is needed or required propertly belongs to and is the responsibility of the state. Before the bylaws, or any changes thereto, are adopted by the cooperative, the cooperative must insure that the bylaw provisions are consistent with any state statutes applicable to the cooperative as well as the loan security documents of REA. In connection with each loan, the attorney certifies that examination has been made of ". . . all corporate proceedings of the borrower relating to the election of the directors and officers . . .", and these actions were in accordance with the cooperative's bylaws. REA also requires the cooperative to advise each member of bylaw changes and to notify each member that copies of the bylaws are available at the cooperative's office.

In summary, REA's policies provide oversight and monitoring, but officially recognize that its cooperative borrowers are independent and private organizations. Provided that a borrower's actions are consistent with its bylaws and legal requirements, REA would intervene in the cooperative's affairs and take appropriate action if the Government's loan security were in danger or RE Act objectives were not being carried out. While REA maintains continuing oversight and makes recommendations through bulletins and individual discussions, the ultimate decisions as to bylaw provisions on nomination and elections rests with borrowers' member-owners.

I hope that these opening remarks have established for the committee, the framework, and methods with which REA approaches its program responsibility. This is directly related to the balance REA has continually strived to maintain between program objectives, the security of the Government's loans, and the self independence of rural people to collectively provide rural America with the benefits of adequate and dependable electric power. The REA contracting and bidding procedures and its relationships with cooperatives' boards of directors have evolved over the years as two of the most successful elements in maintaining this balance.

REA recognizes that its procedures need to be in a process of constant review in order to meet the requirements of a rapidly changing industry. Senator Hawkins, REA would be happy to discuss and consider any recommendations or suggestions this Committee may have as a result of this hearing.

Attached to this statement, which has been made available to you, is some summary data regarding REA bidding and contracting procedures.

Senator Hawkins, I would be happy to answer any questions that you or members of your committee might have regarding REA's procedures.

SUMMARY INFORMATION RELATING TO REA BIDDING AND CONTRACTING PROCEDURES

1. REA borrowers are not subject to Federal procurement regulations. Borrowers are considered private entities.

2. REA always emphasizes widespread competition and award to lowest responsible bidder.

3. REA provides specific contract forms to foster uniformity in bidding and contract terms and conditions.

4. REA, to the extent possible, provides the basic construction specifications for all usual type distribution and transmission facilities. REA issues a "List of Materials Acceptable for Use on Systems of REA Electrification Borrowers" which assures that acceptable products are used for construction. An exception procedure is available for testing and to assure that quality products are not excluded.

5. REA approval is required for all transmission construction contracts and for the major generating plant construction contracts.

6. REA procedures permit distribution cooperatives to enter into routine construction contracts without REA approval.

7. Competitive bid procedures are not required in the procurement of professional engineering and architectural services.

8. Major professional engineering service contracts are approved by REA.

9. REA requires borrowers to "Buy American" with foreign bidders penalized 6 percent in evaluating bids. Provisions for exceptions to this policy are considered when no comparable American equipment is available.

10. REA is not contemplating any new bidding procedures. A revision of REA Bulletin 40-6, "Construction Methods and Purchase of Material and Equipment," is being contemplated but there is no schedule for completing this work.

LISTING OF BASIC CONTRACTING AND PURCHASING METHODS PERMITTED BY REA

*Construction Contracts—Transmission and Distribution*

1. *Labor and Materials.*—Contractor supplies both material and labor and agrees to construct according to specifications, to complete construction by a prescribed time and at specific unit prices. A unit price could be to install a specific size pole, a mile of specific conductor, a specific insulator string, etc. The unit labor construction concept forms the basis for evaluating bid prices and for determining final payments under contract.

2. *Labor Only.*—Contractor agrees to provide only labor for specific construction projects. Cooperative has responsibility to provide proper materials to contractor. The unit labor construction concept forms the basis for evaluating bid prices and for determining final payments under contract.

3. *Generation Plant Component Equipment and Construction Contracts.*—Contractor supplies both material and labor and agrees to construct to meet performance specifications, to complete construction by a prescribed time and for a firm price, subject to prescribed escalation factors.

4. *Purchase Orders and Materials Only Contracts.*—Used to purchase generation, transmission and distribution equipment. The Materials Only Contract is recommended for generation material contracts over $500,000 and for transmission construction material where superior manufacturers' warranties are desired.

BRIEF DEFINITION OF VARIOUS BIDDING PROCEDURES ENDORSED BY REA

1. *Formal Competitive Bidding.*—Requires sealed bids opened and read in public at a specified time and place.

Bids examined upon opening to determine if they meet all major specified requirements (bid bond, proper execution, no exceptions, etc.).

Contract awarded to lowest evaluated bidder.

2. *Informal Competitive Bidding.*—Requires sealed bids delivered at a prescribed time. Bids are opened in private. Bidders are aware that one round of negotiation is permitted to clarify proposals and bidders are permitted to alter prices during negotiations. Pricing data is never revealed to other bidders during negotiations. All bids must be responsive to the bid documents and contract is awarded to lowest evaluted bidder.

3. *Negotiated Bidding.*—Permits unlimited negotiations between bidders and borrowers. Pricing data received from any bidder should not be used to bargain with or be divulged to other bidders. The contract should be awarded on basis of lowest evaluated bid.

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[The following material was supplied by Jack Doyle, Washington Representative, Environmental Policy Center, see p. 8 for the oral presentation of Mr. Doyle.]

OCTOBER 20, 1981.

To: Members, U.S. House of Representatives.
Re: REA Energy Conservation Requirement Needed for Continued Federal Borrowing.
Floor Action: 1981 Farm Bill (H.R. 3603)

DEAR CONGRESSMAN: Rural electric cooperatives are found in at least 200 congressional districts in 46 states. Collectively, some 1,000 REA-supported co-ops comprise the nation's single largest electric distribution system. Their service territories cover 75 percent of the land area of the U.S.

Once a progressive, grass roots movement that transformed rural America by bringing cheap, reliable electric service to even the most isolated community, REA co-ops today have failed badly on the energy conservation front.

Since the arab oil embargo, REA loans and loan guarantees for electric distribution lines, high-voltage transmission lines and powerplants have totaled more than $30 billion. However, REA loans for energy conservation and home weatherization during that same period have totaled no more than $4 million, or about .014 percent

of total REA financing during that period. A pretty poor showing for 7 years and a system that services 8 million REA families, or 25 million consumers.

Even assuming an energy conservation expenditure of $30 million by all REA co-ops, the "conservation share" then rises to a mere .1 percent of all REA financing since the Arab oil embargo. In any event, within the REA system, there is a very wide gap between "electric growth" expenditures and "energy conservation" expenditures, and this has resulted in very large demands on federal borrowing.

While REA and some local cooperatives have moved forward in good faith to try to improve the co-ops' energy conservation record, REA energy conservation programs have generally failed for three reasons: (1) they are not mandatory, (2) they are not tied to clear energy conservation goals (such as specifically targeted 5 and 10 year plans), and (3) they are aimed at the wrong level—some 950 local co-ops rather than the 50 to 60 "G&T co-ops" (i.e., generating and transmission cooperatives who build powerplants and account for the lion's share of REA financing, $5–6 billion annually).

In order to improve REA's energy conservation record, Section 306 of the Rural Electrification Act of 1936 needs to be amended in Title XV of the farm bill, H.R. 3603. An energy conservation amendment aimed at G&T co-ops, with clearly stipulated energy conservation goals, and required as a condition of continued access to the Federal Financing Bank for loan guarantees, would have the effect of coordinating local co-op conservation programs throughout the nation, while reducing the amount of off-budget financing needed for new REA powerplants. In May 1980 testimony before the Senate Subcommittee on Agricultural Credit and Rural Electrification, former REA Administrator Robert Feragen presented a table which showed that the difference in financing requirements for a 1 percent growth rate and a 9 percent growth rate in the REA system during the 1980–1989 period would be $76.2 billion (in constant dollars). Using Feragen's table, and assuming an installed capacity cost of $1,200 per KW, the difference between a 3 percent and a 6 percent growth rate is roughly 16,000 MW, or about $25 billion in financing costs for the 1980–1989 period. Such differences—made possible through an energy conservation requirement aimed at the G&Ts—could result in significant savings in federal credit outlays.

The Environmental Policy Center believes that REA co-ops still need the assistance of the Federal government in the credit market, and that co-ops should still have access to government-backed loan guarantees through the Federal Financing Bank (FFB). However, such continued access and federal assistance must be strictly conditioned on the achievement of reductions in electric energy demand through energy conservation programs.

It is not out of the question, for example, that each G&T system be required to achieve a 1 percent annual reduction in electric demand throughout its system as a condition of REA loan guarantee eligibility. REA power supply borrowers ("G&Ts") could be required to reduce electric demand by 1 percent a year throughout their supply area and among their local distribution cooperatives during the amoritization period of any loan guarantee secured through the Federal Financing Bank of the U.S. Treasury.

Such a requirement would help coordinate local co-op energy conservation programs within G&T systems, would promote jobs in home weatherization and other energy conservation businesses throughout rural America, and would help reduce the amount of off-budget federal borrowing needed by REA to finance new powerplant construction. A 1 percent annual reduction in electric demand by G&T systems would save millions of credit dollars in federal borrowing, "freeing up" such federal borrowing for housing, agriculture and small businesses.

It is certainly in the nation's best interest, and in the interest of reducing the amount of federal borrowing currently taking place in the nation's credit market, that only the most *efficient* and most important federal borrowing be continued. Through properly directed energy conservation programs, REA cooperatives can reduce the amount of federal financing they will need during the next 10 years and beyond.

The Environmental Policy Center therefore urges you to support an REA energy conservation amendment in the 1981 farm bill that saves both energy and money.

Respectfully,

JACK DOYLE,
*Washington Representative.*

# REA Energy Conservation Initiatives Since the Arab Oil Embargo

| | RHETORIC<br>Stated Government Policy and/or REA Programs | REALITY<br>Actual Spending (REA Loans & Loan Guarantees, $ Millions) |
|---|---|---|
| 1974 | "Project Independence" announced | Electric Distribution: $ 618.6<br>Powerlines & Power Plants: $ 974.4<br>Energy Conservation: $ 0 |
| | "REA borrowers are making every effort to adopt rates that will promote the conservation of energy..."<br>REA, Report of the Administrator | |
| 1975 | Energy Policy and Conservation Act of 1975 enacted. | Electric Distribution: $ 700.0<br>Powerlines & Power Plants: $ 1,206.3<br>Energy Conservation: $ 0 |
| 1976 | "Because of changes that have occurred in energy availability and price, REA has been making special efforts to keep its borrowers informed of electric energy conservation measures..."<br>REA, Report of the Administrator | Electric Distribution: $ 750.0<br>Powerlines & Power Plants: $ 1,241.5<br>Energy Conservation: $ 0 |
| 1977 | Carter Administration announces National Energy Plan.<br>REA Energy Conservation Committee established.<br>USDA announces Joint FmHA-REA Home Weatherization Loan Program in February. | Electric Distribution: $ 850.0<br>Powerlines & Power Plants: $ 3,985.5<br>Energy Conservation: $ 0.048<br>REA survey reveals less than 10% of co-ops have energy conservation policy. |
| 1978 | "...aggressive, locally developed and consumer-oriented energy conservation programs will soon become a factor in determining the eligibility of a rural electric distribution co-operative for a loan or loan guarantee..."<br>USDA News<br>August 1978 | Electric Distribution: $ 900.0<br>Powerlines & Power Plants: $ 2,309.0<br>Energy Conservation (REA-FmHA): $ 0.448<br>REA indicates 235 of 983 co-op systems "have agreements with FmHA to process home weatherization loans." |
| 1979 | "Energy conservation programs required in all loan applications from distribution borrowers." (i.e., local co-ops)<br>Rural Lines USA, REA | Electric Distribution: $ 1,000.0<br>Powerlines & Power Plants: $ 5,429.7<br>Energy Conservation (REA-FmHA): $ 0.704 |

REA-FMHA Weatherization Program: A Failure

"Some have criticised the REA for not taking the leadership role it ought to assume, and have said that the co-ops have not been getting the conservation job accomplished. In 1977, the Department of Agriculture announced with a great flourish a home weatherization program whose goal was to weatherize 4 million rural homes. To date, fewer than 3,000 have been weatherized. That effort seems more than somewhat puny."

Senator Edward Zorinsky, "REA and Energy Conservation", Hearing Before the Senate Subcommittee on Agricultural Credit and Rural Electrification, May 6, 1980

"I am sorry to have to admit to the failure of the REA-Farmers Home Administration weatherization program. I think we did not achieve what we had hoped to achieve and what the Department had hoped to achieve. It is not a good record to say that we have only gotten $1,300,000 of weatherization in rural homes.

Robert Feragen, REA Administrator
May 6, 1980

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**1980**

"REA's loan policy effective January 1, 1980, is that borrowers must demonstrate a serious commitment to conservation as a condition of REA loan approval."

Electric Program Chart Book, REA

REA announces new Section 12 loan deferral weatherization program.

| | |
|---|---|
| Electric Distribution: | $ 925.0 |
| Powerlines & Power Plants: | $ 5,660.1 |
| Energy Conservation: | $ 0.050 |

(Section 12 conservation loans)

34 Section 12 weatherization loans were made by REA in 1980.

**1981**

"NRECA took the leadership in bringing our systems into the conservation age.... It has been tough going from a promotional era to a conservation era; but now, most rural electric cooperatives view conservation and load management programs as important options that help them meet their members' needs."

D.L. Knight, Rural Electrification, February 1981

| | |
|---|---|
| Electric Distribution: | $ 8[illegible]0 |
| Powerlines & Power Plants: | $ 4,994.9 |
| Energy Conservation: | $ 0.903 |

173 of REA's 983 active co-op borrowers have agreed to participate in Section 12 weatherization program.

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As of October 1, 1981, REA has still not established a mandatory energy conservation program with clearly specified goals for achieving reductions in electric energy demand, administered through G&T co-ops.

## REA ENERGY CONSERVATION PROGRAMS

| | | # of Loans | Amount of Loan |
|---|---|---|---|
| REA-FmHA Weatherization | 1977 | 59 | $ 48,000 |
| | 1978 | 513 | 448,000 |
| | 1979 | 796 | 704,000 |
| | Subtotal | 1,368[1] | $1,200,000 |
| Section 12-Energy Resource Conservation Loans | 1980 | 34 | 50,000 |
| | 1981[2] | 779 | 903,000 |
| | Subtotal | 813 | $ 953,000 |
| | TOTAL | 2,181 | $2,153,000 |

Source: U.S. Rural Electrification Administration

1. Only 240 of the 1,368 loans made in this weatherization program were made through REA co-ops.
2. As of August 1981. Although 779 loans have been made by REA co-ops in 1981, there are over 8 million households served by REA co-ops nationwide. Moreover, only 44 co-ops--less than 5% of all REA co-ops--have actually made one or more Section 12 Energy Resource Conservation loans in 1981.

STATES IN WHICH REA CO-OPS HAVE NOT MADE AT LEAST 1 SECTION 12
ENERGY RESOURCE CONSERVATION LOAN
1980-1981

| | | |
|---|---|---|
| Alabama | Maine | Oklahoma |
| Alaska | Maryland | Oregon |
| Arkansas | Michigan | Pennsylvania |
| California | Mississippi | Tennessee |
| Delaware | Montana | Utah |
| Idaho | Nebraska | Vermont |
| Illinois | Nevada | Virginia |
| Indiana | New Hampshire | West Virginia |
| Iowa | New Jersey | Wyoming |
| Kentucky | New York | |

Source: U.S. Rural Electrification Administration, as of August 1981.

POWER SUPPLY FINANCING NEEDED BY
REA BORROWERS AT VARIOUS LEVELS OF ELECTRIC GROWTH

| Annual Load Growth, 1980-89 | Percent of Total REA Borrower Needs Supplied by Borrower's Own Generation 1/ | | MW of Additional Capacity Financed 2/ | | | Billion Dollars of Financing Required | | | | | |
|---|---|---|---|---|---|---|---|---|---|---|---|
| | | | | | | Constant (1980) $ 3/ | | | Nominal $ 4/ | | |
| | | | Total | Annual Average | | Total | Annual Average | | Total | Annual Average | |
| | 1980 | 1989 | 1980-89 | 1980-84 | 1985-89 | 1980-89 | 1980-84 | 1985-89 | 1980-89 | 1980-84 | 1985-89 |
| 1% | 36.0 | 51.7 | 6,909 | 835 | 563 | $10.5 | $ 1.3 | $ 0.9 | $$14.6 | $ 1.5 | $ 1.6 |
| 2% | 36.0 | 52.5 | 9,937 | 1,081 | 904 | 14.9 | 1.6 | 1.4 | 21.2 | 1.9 | 2.3 |
| 3% | 36.0 | 53.7 | 13,796 | 1,393 | 1,366 | 20.7 | 2.1 | 2.0 | 29.9 | 2.6 | 3.5 |
| 4% | 36.0 | 54.4 | 18,518 | 1,759 | 1,944 | 27.8 | 2.6 | 2.9 | 40.6 | 3.1 | 5.0 |
| 6% | 36.0 | 55.8 | 30,572 | 2,638 | 3,477 | 45.9 | 4.0 | 5.2 | 68.2 | 4.6 | 9.0 |
| 8% | 36.0 | 57.2 | 46,631 | 3,759 | 5,567 | 69.9 | 5.6 | 8.4 | 105.1 | 6.6 | 14.4 |
| 9% | 36.0 | 57.8 | 57,830 | 4,444 | 7,120 | 86.7 | 6.7 | 10.7 | 131.2 | .8 | 18.4 |

Assumptions: 1/ REA's best judgement concerning source of future power supply for REA borrowers.

2/ 50% load factor; a four year lead time between loan approval and on line dates; reserves equal 20% of required capacity.

3/ 1980 cost per MW of $1,200 plus financing for bulk transmission facilities in an amount equal to 25% of generating plant investment.

4/ Constant (1980) $ inflated at an annual rate of 8%.

Note: MW = one thousand Kilowatts of capacity.

Source: Robert W. Feragen, Hearing Before the Subcommittee on Agricultural Credit and Rural Electrification, Committee on Agriculture, Nutrition, and Forestry, U.S. Senate, May 6, 1980.

BEST COPY AVAILABLE

## REA and Energy Conservation: The Need To Do More

*REA: "An Enormous Opportunity For Conservation":*

"Rural electric co-ops are today the fastest growing segment in the electric utility industry and are expected to provide 20 percent of the Nation's electric supply by the year 2000. There are approximately 1,000 such co-ops serving 25 million people and occupying 75 percent of the land area of the United States. For this reason alone, they provide an enormous opportunity for conservation and small-scale renewable technologies.

"The Rural Electrification Administration is a central force in the rural electric movement by helping the co-ops finance service to rural customers. Each year the REA provides billions of dollars in loans and loan guarantees to these utilities. With its vast resources, the agency could also support co-op projects in conservation and renewable energy technologies, which would be infeasible without REA financial and technical assistance." (Senator Paul Tsongas, Senate Subcommittee on Energy Conservation and Supply, July 11, 1979.)

*REA Administrator, Harold Hunter, Supports Energy Conservation:*

"Rural people should be made aware of how a successful load management program can defer the need for additional plant. The message is clear: each dollar invested in additional plant increases the average cost of serving consumers. That is why borowers' progress in home weatherization, load management, and supplementary technologies are so important to REA borrowers and consumers they serve." (Harold V. Hunter, Washington, D.C., September 21, 1981.)

*GAO Cites G & T Role in Energy Conservation:*

"REA, working primarily through its distribution system borrowers, has taken actions to help solve our Nation's energy problems. We believe, however, that the power supply systems could be better used as a focal point for this effort.

"The power systems [i.e., G & T co-ops], with their overall responsibility for planning for and meeting the power requirements of the distribution systems they serve, are in good position to help plan to (1) reduce the demand for energy through conservation measures, (2) use available plant capacity as efficiently as possible through effective load-management efforts, and (3) use alternative renewable energy sources to the maximum extent practicable to reduce our Nation's dependence on foreign oil and to conserve our own natural resources . . . ." (Comptroller General's Report to the Congress, "Financing Rural Electric Generating Facilities: A Large and Growing Activity," November 28, 1980.)

*20 Percent Savings in Wisconsin Dairy Industry:*

". . . The Wisconsin Energy Office has predicted in testimony before the State's Public Service Commission that one device alone—heat exchangers for cooling milk and heating water—can be responsible for a 20 percent reduction in Wisconsin's agricultural electrical energy use by the year 2000." (Randy Freeman, Pierce-Pepin Electric Co-op, Wisconsin, Hearing before the House Subcommittee on Conservation and Credit, March 1980.)

*REA Energy Conservation: Long-Term Budget Savings:*

"In addressing the rural electric cooperative leadership at the NRECA annual meeting in New Orleans, . . . it was stated that it is in the nature of energy conservation programs to have short-range impacts upon revenues. But it was emphasized that the long-term benefits of averting substantial capital outlays for new electric capacity would be a much greater gain for their future financial outlooks than the actual cost of conducting conservation programs or the short-term negative impact upon revenues.

". . . As I stated previously, conservation practices for rural cooperative members will have a negative impact on system revenue, but will produce long-term benefits because the need for additional high cost new capacity will have been obviated.

"It should be remembered that the continuing growth in the number of consumers on rural electric systems will mitigate the effects of reduced consumption by the present consumers . . . with a 1 percent annual load growth a total of about 7,000 MW of capacity, at a cost of $10.5 billion (1980 dollars) will be required. If, however, the annual load growth were 9 percent, almost 58,000 MW of capacity, at a cost of almost $87 billion (1980 dollars) will be required. In all likelihood, the actual load growth through this period will be in the middle of these two extremes. This indicates the importance of an effective conservation program to reduce load growth . . . ." (Robert Feragen, Former REA Administrator, Hearing before the Senate Subcommittee on Agricultural Credit and Rural Electrification, May 6, 1980.)

*Former Agriculture Secretary Bob Bergland: REA & Energy Conservation:*

"I have asked NRECA to work with REA to develop an aggressive and effective energy conservation program and to help borrowers with their own initiatives . . . . An aggressive energy conservation program—one which devotes a reasonable amount of resources and personnel—is the best opportunity to keep costs down and minimize the need for additional loan funds. Such a program should, in the consumer and national interest, be a requirement for continued REA financing." (Bob Bergland, REA New Managers Conference, Washington, D.C., April 1978.)

[Reprint from Rural America, February 1980]

HIGH-POWERED CONTROVERSY

For more than 40 years, the rural electrification movement has been a force for progress and social change in rural America. Beyond the electrification of millions of farms and rural homesteads (no simple achievement in the 1930s), the Rural Electrification Administration (REA) and its nearly 1,000 local electric co-ops have helped create an important network of consumer-controlled institutions in rural communities that is unique in the social history of our nation. The movement reflects a successful partnership between federal commitment and resources on the one hand, and local leadership and organization on the other—a partnership that has withstood four decades of determined opposition from private utilities and other vested interests.

Since its inception, Rural America has consistently identified itself with the progressive historic forces that helped create the rural electric movement, the Farm Security Administration and other efforts to improve the lives of rural people. Many times, we have joined with local electric co-ops and their national association, the National Rural Electric Cooperative Association, to assure rural equity in the development and implementation of federal policies.

In recent months, the rural electric program has come under criticism for its policies in the areas of energy development and conservation, and a spirit of reform aimed at the rural electric cooperatives is emerging in many rural areas. Increasingly, in publications like *Lines Across the Land* (which is reviewed on page 6), the local co-ops are being linked both to private coal companies and to private interests seeking to develop synthetic fuels. For some time, we have been concerned that, despite some pioneering conservation practices on the part of Basin Electric Cooperative and other individual co-ops, the organized rural electric voice at times has sided with the private power concerns against aggressive federal stripmining regulations and in favor of expanding nuclear power.

As concern and controversy over national energy policies increase, it is inevitable that there will be closer scrutiny of the practices of REA and other publicly controlled electric systems. This, we believe, is desirable, since such examination and debate can only lead to a strengthened and invigorated REA system. We reject the notion that we cannot criticize REA without supporting the adversaries of the rural electric program; similarly, we reject the view that the rural electric co-ops are indistinguishable from private, investor-owned utilities. It is impossible to adequately address rural energy issues without thoroughly examining the role played by REA and, where necessary, insisting that those practices working to the detriment of rural people be changed. After all, the rural electric system is our system, and we have more than just a minor stake in how it works.

[Reprint from Des Moines Sunday Register (Iowa), May 10, 1981]

RURAL ELECTRIC CO-OPS SIZZLE OVER PLANS TO CUT THEIR SUBSIDIES

(By George Anthan of the Register's Washington Bureau)

WASHINGTON, D.C.—They begin arriving here tonight, the first contingent of an army of officials and board members of rural electric cooperatives from across the country. They're angry at President Reagan's attempt to cut the subsidies to which they've become accustomed in the 45 years since the New Deal replaced the countryside's familiar windmills with power lines.

By the end of this week, more than 2,000 officials and employees of the cooperatives from some 200 different congressional districts will have told their story to senators and congressmen. Their message: Cutting back the federal subsidies to the rural electrics won't save a dime in federal spending but will cause already burdened rural consumers to pay even more for their electricity.

Already, a wide range of congressmen and senators who represent rural areas, including some usually loyal Reagan supporters, have notified the White House that this is where they draw the line

FARM-STATE UNITY

Many farm-state members of Congress are rallying behind the co-ops in their battle with the White House. Last month, eight senators, including Republicans Roger Jepsen and Charles Grassley of Iowa, sent a letter to Reagan opposing moves to cut co-ops off federal financing. "We must not leave the rural cooperatives out in the cold," Jepsen said.

The administration may have some unlikely allies in its fight to trim the cooperatives' subsidies since an environmental group released a controversial study of the rural electrics. The study charged the cooperatives had bypassed environmental laws, avoided energy conservation, abused rural landowers and effectively isolated their member-owners from the decision-making process.

In fact, the whole world of the rural electric cooperatives has been turned topsy-turvy. Among their chief allies, now, are their once bitter enemies—the nation's privately owned utility companies. This is because the cooperatives, in the last decade or so, have entered into a series of joint ventures with the private firms to build large nuclear and coal-fired generating plants. The private utilities have benefited because the cooperatives bring with them the low-cost credit the government makes available.

BUYING NUCLEAR PLANTS

For example, two Iowa co-ops—Central Iowa and Corn Belt—used some $66 million is subsidized federal funds to buy a 30 percent share in the Duane Arnold nuclear power plant constructed by Iowa Electric Light and Power Co.

The Regan administration contends the rural electric co-ops have largely accomplished the task of providing power to rural and isolated parts of the country, and should depend more on commercial credit.

The administration wants to raise interest rates on the direct government loans from 2 percent to 5 percent.

Also, Reagan wants to end the practice of allowing the big generating and transmission cooperatives to get most of their money from the Treasury, at rates averaging about 1.5 percent below commercial credit. Through 1979, the Treasury had provided some $15 billion to the cooperatives.

The cost of this borrowing doesn't show up in the federal budget, a practice that has been criticized by David Stockman, Reagan's budget director, and by the General Accounting Office, the congressional investigating agency.

ONCE UNTOUCHABLE

Rural electric cooperatives were considered politically untouchable until late in 1979, when the Environmental Policy Institute issued a 750-page report titled, "Lines Across the Land."

The institute decided to undertake the study of the system when the National Rural Electric Cooperative Association successfully lobbied in 1977 against some of the more stringent environmental standards in proposed strip mine legislation.

Jack Doyle, the study's author, stated that while rural electrification began as a "progressive, populist movement" designed to help lift rural people out of the poverty of the 1930s, "today, rural electrification is losing its connection with the land and is turning away from the farmer."

For one thing, the study noted, rural electrics increasingly are serving suburban customers, including large industrial and commercial firms.

And instead of concentrating almost entirely on distributing electricity, the systems are engaging in large-scale power generation, involving the partnerships with private utilities and membership in multi-state transmission grids.

The Doyle study and the Reagan administration both have noted that low-cost federal money increasingly has gone to those cooperatives set up to generate power. The report emphasized that the joint ventures with private companies have destroyed the traditional role of the rural system in providing a service standard against which the investor-owned companies could be measured.

"ANTI-ENVIRONMENTAL PHILOSOPHY"

The report stated that "the entire rural electric hierarchy . . . is arrayed in almost constant opposition to environmental laws and programs, and this anti-environmental philosophy is reflected in the co-ops' national platform, in their advertising, in their editorials, in their lobbying at the state and federal levels and in their legal interventions and lawsuits."

But perhaps the most stinging criticism was that control of the system had effectively been usurped by its managers and by virtually self-perpetuating boards of directors of individual cooperatives.

The study charged that some co-ops routinely deny information to their members and limit access to meetings at which major decisions are made. It contended that many important decisions about investment and expansion are made by management and that local boards of directors are, in effect, compelled to go along.

Many of the charges have been denied by the National Rural Electric Cooperative Association, which is supported by member cooperatives and also serves as the industry's lobbying group.

SOME BOARDS "TOO ENTRENCHED"

But Robert Nelson, a spokesman for the association, does acknowledge that "all of us have been critical of some" cooperatives. "Some old boards of directors," he said, "did get a little bit too entrenched."

But Nelson and other association officials say the rural system continues to be a leader in energy conservation and in pushing solar and wind power, and he noted that the system's annual increase in demand, which had been 10 percent, now is down to about 3 percent or less.

The association called the Doyle study "an astonishing document," produced by "a group of environmental idealists opposed to cooperative growth in providing central station electricity." It contended the study was "naive, irresponsible and biased."

The administration has estimated that by eliminating the $37.5 billion the co-ops probably would borrow through 1986, the government would save about $427 million in interest subsidies.

Officials have estimated that co-op customers in many areas currently pay up to 12 per cent less for electricity than do many urban customers of privately owned utilities. In these cases, they say, the higher costs associated with commercial borrowing can easily be passed on to customers. In some rural areas, though, electricity customers already are charged rates comparable to those in urban sections and the administration's plan will mean significantly higher charges, officials have conceded.

Still, the Congressional Budget Office has concluded, "Rural customers, as a group, are no longer economically disadvantaged relative to all other customers."

SIMPLE STATISTICS

The cooperative association believes some simple statistics explain why the government should continue to help provide power in rural areas. For example, rural systems average 4.6 consumers per mile of line, while investor-owned utilities average 35.8 customers per mile. And, it says, revenue per mile of line for the co-op system is $2,887, while the private firms get an average of $36,652.

Robert Partridge, executive vice president of the association, asks why anybody should want to change a system that is "working extremely well."

"We simply will not stand for the erosion of a program which so demonstrably is basic to our nation's prosperity."

This week, members of Congress and the Reagan administration will find out first-hand just who he means by "we."

[Reprint from the Kansas City Star, Sept. 19, 1979]

STUDY RAPS ROLE OF ELECTRIC CO-OPS

(By Kathleen Patterson, of the Washington Bureau)

WASHINGTON—Rural electric cooperatives, born in the New Deal to serve farmers, have developed enough political clout in 44 years to "undo environmental laws, avoid energy conservation . . . and abuse agricultural landowners," according to a year-long study released today by the Environmental Policy Institute.

The cooperatives form the largest single electric distribution system in the country, with customers in 46 states and distribution rights covering 75 percent of the land, including 102 of Kansas' 105 counties and 113 of the 115 counties in Missouri.

The non-profit environmental group was prompted to study the growth of rural electric co-ops when the National Rural Electric Cooperative Association successfully lobbied two years ago against some of the more stringent environmental standards proposed in strip-mining legislation.

Ms. Louise Dunlap, president of the institute, said today that "one of the reasons we decided to do the study was because it was apparent through other work that

they were a powerful entity working contrary to everything we were working for. And we knew very little about them."

Rural electrification began as a "progressive, populist" movement, Jack Doyle, author of the study, said: "Today, however, rural electrification is losing connection with the land and is turning away from the farmer," the study states.

Ways in which the rural electric co-ops have changed, according to the study and comments by Doyle:

Customers have changed. Co-ops are increasingly serving suburban developments, including areas around St. Louis and Kansas City, Kansas, the study states. In the west, particularly, large industrial and commercial firms are customers.

A case study in Nebraska found that since 1969 at least 650,000 acres have been brought under center-pivot irrigation systems, most using electricity supplied by rural co-ops, thus raising questions about abuse of scarce ground water. Rural co-ops also are moving into electric irrigation in Missouri, the study notices, "though in many areas of these states irrigation is neither appropriate nor necessary for crop production."

The goals of co-ops are changing, Doyle said, from distributing electricity to rural customers to engaging in large-scale power generation. Co-ops, using federal money from the Rural Electrification Administration, "have embarked on programs building coal-fired and nuclear-power generating plants and multistate transmission grids in joint ventures with investor-owned utilities and coal companies, once their historical adversaries."

Federal funding has gone increasingly to generating and transmission co-ops, which distrubute power through state rural electric associations and engage in joint ventures with investor-owned utilties, thereby thwarting a traditional role of electric co-ops in providing a service standard against which the regulated, investor-owned power firms can be measured.

Five of the generating and transmission co-ops, including Associated Electric of Springfield, Mo., account for 42 percent of existing REA loan guarantee commitments, the study notes.

Because the rural electrification groups increasingly identify themselves with the utility industry, Doyle said, "they are starting to hurt their traditional goals and the groups they have worked with," including farm groups and some local co-op members.

"Rural electric politics have shifted from those designated to protect the farmer's economy and his resources to those designed to facilitate the building of power lines," a study summary notes.

Growing conflicts with farm interests include taking prime farmland for powerplants, reservoirs, transmission lines and use of surface and underground water for powerplant cooling, coal preparation and eventually for coal-slurry pipelines.

The study states that co-op high-voltage transmission lines are or will be crossing cropland and rangeland in a dozen states, including Missouri. "Rural electric cooperatives building powerplants with large water requirements in Wyoming, Kansas and several other states have begun to compete with farmers, ranchers and local irrigators for limited water supplies," the study says, adding that co-ops in Kansas have purchased ranches to acquire water rights.

One of the strongest criticisms voiced by the environmental group has to do with what rural electric cooperatives are not doing in energy conservation. Co-ops "have given less than fair consideration to conservation or solar energy or small-scale power development," Doyle said, despite the contention that the type of rural network established in the electrification movement is ideal for such innovation.

He said one exception is the rural co-op association in Arkansas, where members believe they can reduce electricity use by 40 percent through conservation—the association has begun manufacturing home insulation and works with members to install both storm windows and insulation.

Such conservation efforts, Doyle indicated, can discourage the construction of new powerplants and thereby save money for the rate-payers. Working against that, they argue, are the new partnerships with investor-owned utilities, who, they indicate, are using the rural cooperatives to help defray costs of building new large-scale generating capacity.

Ms. Dunlap said the federal government has the leverage to encourage co-ops to be more active in conservation. "We feel this large system has the energy conservation potential, and the president and the Carter administration must focus on it." She said her organization would be attempting to meet with Agriculture Secretary Bob Bergland and would be in touch with the White House in an effort to convince the administration to use its executive authority to redirect rural electrification policy.

The study concludes by calling on "REA, NRECA, co-op members, agricultural organizations, public power advocates, consumer groups and rural citizens" to begin a "comprehensive reassessment of the REA network with an eye toward using that network to achieve rural energy parity and national energy leadership in the 1980s."

[Reprint from Rocky Mountain News, Denver, Colo., Sept. 20, 1979]

## Environmental Policy Unit Assails Nation's REA Program

(By Charles Roos, News Washington Bureau)

Washington—The Environmental Policy Institute said Wednesday the nation's Depression-born rural electric program has lost its way and needs redirection from the White House.

Increasingly, the institute charged, rural electric associations are losing interest in farm members and are expanding into suburbs, heavy industry and expensive playgrounds—including Colorado ski areas.

Consistently, the institute said, REAs have neglected energy conservation and REA lobbyists have worked to undermine environmental laws.

The institute, a non-profit research group, issued a 761-page book reporting on a year-long study by Jack Doyle of the more than 1,000 local and regionals REA cooperatives.

A national spokesman for REAs, Bob Nelson, said he hadn't seen the report. He said the institute's past criticisms were naive and erroneous.

I think the basic problem is that what they want is a no-growth policy, Nelson said.

He said the REA movement obviously has changed in the 44 years since it was created to bring electric power to the nation's farms during the Depression. But he insisted it isn't shirking its historic duty of serving rural America.

In Colorado, every county except Denver has at least some REA service.

Louise Dunlap, the institute president, said the report takes on special significance since an administration review of REAs that had been started by the Office of Management and Budget was dropped last December following massive REA protests.

She said the institute will seek action by the president, his domestic policy staff and Agriculture Secretary Bob Bergland to try to redirect REAs toward greater conservation, more attention to the environment and the promotion of solar and other renewable energy alternatives.

REAs are heavily dependent on federal loans and loan guarantees—to the tune of billions of dollars a year—and are sensitive to executive pressure even without going to Congress, Dunlap said.

"The president may have a very low popularity rating," she said, "but he still has all of his executive powers."

It isn't the institute's conclusion that the REAs shouldn't exist, she said, but rather her organization thinks the cooperatives represent a great opportunity for more attention to conservation and innovative energy technologies.

Doyle's report stresses the growing power of regional REA "generation and transmission" cooperatives within the rural electric movement, and it refers several times to the large Colorado-Ute operation headquartered at Montrose.

Colorado-Ute is heavily involved in serving mining and industrial interests in western Colorado and in providing electricity to such resort industries as Vail, Aspen, Steamboat Springs, Telluride, Crested Butte and Tamarron, the report noted.

In one period of less than four years in the early 1970s, the report said, Colorado-Ute increased its rates six times for a total of 73 percent.

Dunlap said her group became interested in REAs and undertook the study after observing how effectively the cooperatives were in opposing virtually everything the institute supports.

She cited one 1978 listing, by a South Dakota REA official, of "particularly troublesome" laws for REAs. Among others these included the Clean Air Act of 1977, the Endangered Species Act of 1973, the Historic Preservation Act of 1972, the Wilderness Act of 1964, the Wild and Scenic Rivers Act of 1968 and the National Forest Management Act of 1976.

Nelson said REAs are obliged to serve industry, recreation and the suburbs because these customers are within their prescribed service areas.

Contrary to the institute's report, he said, REAs have been actively pushing conservation.

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[Reprint from the Herald Dispatch, Huntington, W. Va., Sept. 28, 1979]

## Co-Op Member Control Called Myth

(By Jim Ross, Herald-Dispatch staff writer)

Member control of 1,000 rural electric cooperatives across the U.S. is a myth, says a Washington-based organization that has been studying the problem for the past 18 months.

"Rural Electric Cooperatives: The Changing Politics of Energy in Rural America," released recently by the Environmental Policy Institute, criticizes management of rural co-ops—including Buckeye Rural Electric Cooperative of Gallipolis, Ohio—and charges them with obstructing member participation.

In the 761-page book, author Jack Doyle says the co-ops also have resisted energy conservation and environmental protection, and abused farmers and rural landowners.

Dolye cites cases from dozens of co-ops around the country in which boards of directors have denied customer-owners the right to participate in their company's management by refusing them access to board meetings and not releasing corporate information.

For more than 40 years, the co-ops have represented themselves a member-controlled, consumer-owned and operated systems, but instead have come to be characterized by member apathy and management from the top down, rather than from the bottom up, Doyle said.

Some co-ops have board members who have been serving for 20 to 30 years, Doyle said. Because of board rules, nomination of candidates by the membership, as well as the board, is nearly impossible, he added.

Doyle said most of the information for the study came from case studies of co-ops in 14 states written by local citizens and co-op members.

"A number of critiques have come from members at the local level who have tried to take active participation in management. If the co-op system is true to its charter, it should not resist member participation," Doyle said.

Robert Cleveland, president of Ohio Rural Electric Cooperatives Inc., said he had not seen the report, but understood that no management people were contacted as part of EPI's research.

"I don't necessarily think it's all critical," Cleveland said. "What they've done is to glean newspaper articles and take them out of context.

"They make a big to-do about servicing industry and over-head sprinklers for irrigation. We don't see anything wrong with providing electricity to industries in rural America," Cleveland added.

"There is nothing inherently wrong with serving industry," Doyle replied. "We are pointing out their change in customer makeup. They are increasingly composed of industrial, recreational and suburban loads. The farm load is an increasingly shrinking part of their load."

Doyle added that co-ops were formed to serve farmers in isolated areas, not suburban and industrial areas.

Wynemma Patterson, a leader of a group of customers who twice made unsuccessful attempts to gain seats on the Buckeye Rural board of directors this year, said she agrees with Doyle's findings.

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